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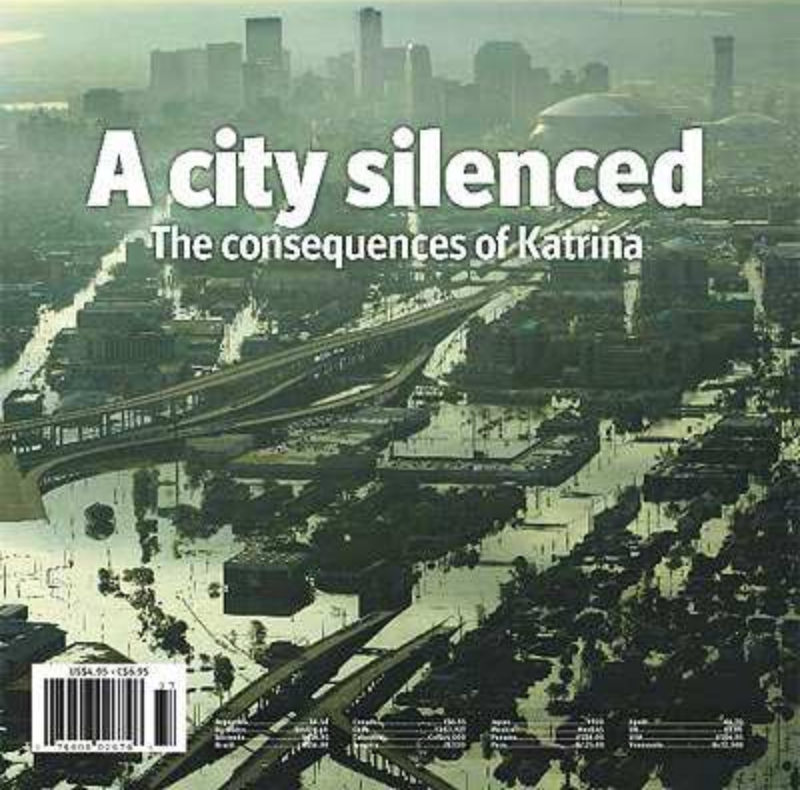

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Politics this week

Sep 1st 2005
From The Economist print edition

After the flood

Reuters

Hurricane Katrina, one of the worst natural disasters in America's history, pounded the Gulf Coast with winds of over 145mph. On some estimates thousands of people were killed in Louisiana and Mississippi. Alabama and Florida were also affected. **New Orleans**, which is under sea level, suffered severe flooding when two levees were breached—the state's governor ordered the city's residents to leave as rising floodwaters worsened sanitary conditions and hampered rescue efforts. George Bush cut short his holiday in Texas and returned to Washington, DC, where he said the region may take many years to recover.

See article

A congressional study into worldwide **weapons transfers** reported they were at their highest level since 2000. Total agreements on weapon sales were $37 billion in 2004, a 30% increase on 2003. The United States made the most agreements, taking a third of the market.

The Census Bureau said that 12.7% of Americans were living below the **poverty** threshold in 2004. The three states with the highest poverty rates were Mississippi, New Mexico and Louisiana.

Moving on

Indonesia freed almost 1,500 people suspected of being tied to the separatist Free Aceh Movement in its northern province of Aceh. The amnesty, which included the release of four senior rebels, complied with the terms of a recent peace deal between the government and the rebels.

A congressional committee in the **Philippines** threw out three impeachment complaints against President Gloria Arroyo, who is alleged to have been recorded on an audio-tape plotting to rig an election. The country's House of Representatives is expected to vote on whether to impeach Mrs Arroyo next week.

See article

China announced plans to stop work at one-third of its coalmines in a bid to reduce casualties in the industry; 3,000 miners have been killed so far this year. The 7,000 affected mines must now meet national safety standards before they can reopen.

Bridge of death

Reuters

After weeks of wrangling and missed deadlines, a draft constitution was agreed upon by **Iraq's** Shia Arab and Kurdish politicians but not by Sunni Arabs on the drafting committee. It will go to a referendum in October. But that news was overtaken, three days later, when at least 700 and possibly up to 1,000 Shia worshippers died after mortars were fired into a pilgrimage in Baghdad; rumours of an impending suicide-bomb attack then caused a lethal stampede on a bridge, causing many to drown while others were trampled to death.

See article

Binyamin ("Bibi") Netanyahu, a former prime minister who recently resigned as finance minister in protest against the withdrawal of **Israeli** troops and settlers from the Gaza strip, said he would seek to win the leadership of Israel's ruling Likud party from the prime minister, Ariel Sharon. Meanwhile, Israel held its first public talks with **Pakistan**. The meeting, in Istanbul, is unprecedented—the two countries have had no formal diplomatic ties.

See article

At least four of **Lebanon's** top security men, all with strong ties to Syria, were arrested as a result of a continuing UN investigation into the assassination in February of the country's long-serving former prime minister, Rafik Hariri. One was later released.

See article

In a bad week for **Uganda's** battle against AIDS, donors halted money to the country's AIDS programme amid accusations of financial mismanagement. The UN also criticised Uganda for buckling under American pressure to put more emphasis on abstinence than on condoms.

In **Zimbabwe**, members of parliament passed changes to the constitution that give President Robert Mugabe more power. The government will now be able to expropriate land without being challenged in court, and remove the right to a passport from those it deems a danger to security, with no appeal.

Sudan's parliament met for the first time under the provisions of a peace agreement signed in January between the central government in Khartoum and the southern rebels. Under the new deal, President Omar Bashir's ruling National Congress takes 52% of the seats, while the former rebels in the south have 28%.

Workers' woes continue

Tarso Genro, who became president of **Brazil's** ruling Workers' Party in July after a corruption scandal toppled his predecessor, said that he would not stand for re-election later this month after losing an internal power struggle.

Deforestation of Brazil's Amazon region has been cut by nearly a half over the past 11 months, according to satellite data released by the environment ministry. It nevertheless still proceeds apace. From August 2004 to June 2005, an estimated 9,000 square kilometres of forest were destroyed, compared with nearly 19,000 over the previous year.

The World Trade Organisation ruled that America's imposition of duties on **Canadian softwood lumber** did not violate international law. The interim decision, which is subject to appeal, broadly

contradicts last month's decision by a NAFTA panel instructing the United States to refund $4 billion in tariffs it had collected from Canadian softwood lumber exporters.

How it all started

AFP

Top European leaders travelled to Gdansk to mark the 25th anniversary of the founding of Poland's **Solidarity** trade union. Solidarity's then leader, later Polish president, Lech Walesa, led tributes to the importance of the union in toppling communism across eastern Europe.

Two fires in Paris slums caused the deaths of 24 **African immigrants**, including 18 children, mostly from Mali and Côte d'Ivoire. Arson seems unlikely, but the fires have raised questions about poor housing conditions for immigrants.

See article

The European Union trade commissioner, Peter Mandelson, continued to struggle to resolve the “bra war” over **Chinese textile imports**. The conflict has led to millions of items of Chinese-made clothes being impounded in European warehouses.

See article

The Turkish and Greek-Cypriot governments clashed over the wording of a declaration on **Cyprus** that the EU is preparing to make. Both sides have threatened to walk away from Turkey's EU entry talks, due to begin early next month.

See article

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Business this week

Sep 1st 2005
From The Economist print edition

Taxed

KPMG agreed to pay $456m to settle an investigation by America's Justice Department into a fraudulent tax-shelter scheme offered to wealthy individuals. The “Big Four” accountancy firm will not now face criminal charges (although it has admitted wrongdoing and is on probation until the end of 2006), thus avoiding the fate that befell Arthur Andersen, which was brought to trial for its part in the Enron affair. However, eight former partners at KPMG were indicted. The shelters, which operated between 1996 and 2002 cost the American government billions of dollars in lost tax revenue.

See article

It was reported that **Industrial and Commercial Bank of China**, one of China's big state-owned lenders, had agreed to sell a 10% stake to a consortium led by Goldman Sachs for $3 billion. Another top institution, **Bank of China**, said that Temasek, the Singapore government's investment agency, would pay $3.1 billion for a 10% stake, in BoC's second deal with foreign investors in two weeks.

See article

MasterCard announced it would have an initial public offering early next year that will give investors a 49% stake. The credit card association is also adopting new governance structures, including a board of mostly independent directors. MasterCard is currently owned by 1,400 financial institutions that issue its cards, but may face huge liabilities if it (and Visa) lose an antitrust lawsuit brought by competitors.

See article

Old Mutual, a financial services group based in South Africa, confirmed it had held discussions about taking over **Skandia**, the Nordic region's biggest insurer, for around $5.7 billion. Skandia has suffered a series of high-profile resignations and financial scandals of late and recently reported a second-quarter net loss of SKr 1.47 billion ($192m).

Fortress France?

France's industry minister, François Loos, said he would soon publish a list of the country's strategic industrial sectors that will be protected from **foreign takeovers**. Mr Loos's comments came the same week that a French building-materials firm made a *euro*5.4 billion ($6.6 billion) hostile bid for a British rival.

See article

In a deal that will create the world's biggest satellite operator, **Intelsat** announced it was buying **PanAmSat** for $3.2 billion. The merged firm will operate 53 satellites and combine Intelsat's telecoms speciality with PanAmSat's focus on television services.

See article

Following last week's unveiling by Google of its new voice communication service, **Microsoft** said it was buying **Teleo**, a small firm specialising in voice-over-internet-protocol (VOIP) technology. The move is more positioning in the industry's ongoing expansion into providing telephone services over the internet.

See article

Creative, a digital audio company based in Singapore, revealed that it had been awarded a patent for its “Zen” portable media-player interface. The technology is used in **Apple Computer's** iPod, which Creative said is covered by the patent. Pundits speculated that Apple might face a lawsuit for royalties.

Workers at **Boeing** were due to vote on the terms of a new contract. Unions grumbled about pensions and that workers in the aircraft manufacturer's Wichita plant would be treated differently; strike action was mooted.

Injecting some capital

In a move that plants it firmly in the vaccine business. **Novartis**, a large pharmaceutical firm based in Switzerland, offered to buy the 58% of shares it does not already own in **Chiron,** for $4.5 billion. Based in California, Chiron earlier said it should be able to supply America's flu vaccine this winter. The plant that produces Fluvirin (in Britain) had its licence suspended last year, but has since received a favourable inspection from American regulators.

ABN Amro announced what is thought to be one of the biggest-ever **outsourcing** deals. The Dutch bank said it will pay five groups, including IBM and India's Infosys, *euro*1.8 billion ($2.2 billion) over five years to manage its IT systems, which it hopes will result in annual savings of *euro*258m.

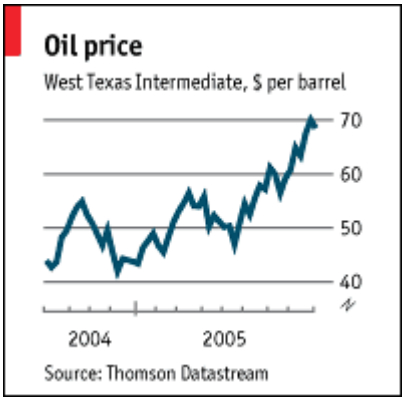
In order to stem a sharp fall in the rupiah, **Indonesia's** central bank raised its key interest rate by three-quarters of a percentage point, to 9.5%. The currency declined by around 10% against the dollar in August as investors worried about the country's extensive fuel-price subsidies to consumers.

See article

Katrina's waves

Oil prices pushed above $70 a barrel as Hurricane Katrina forced the shutdown of operations near America's Gulf Coast, affecting 25% of the country's oil production. But the federal government's decision to loan crude oil from its strategic stockpile to refiners to alleviate the crisis eased prices back below the $70 mark.

See article



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Hurricane Katrina

A city silenced

Sep 1st 2005
From The Economist print edition

America can learn from a tragedy that need not have done so much harm

AP

IT WILL be deceptively easy for statistically minded historians to play down the magnitude of what Hurricane Katrina did to America's Gulf coast this week. It pales in comparison with last December's Asian tsunami, which left more than 200,000 dead. Indeed, the death toll in Louisiana, Mississippi and Alabama, which could turn out to be 1,000 or more, was sadly and promptly matched by this week's other tragedy, the deaths in a stampede of Shia pilgrims in Baghdad.

But do not underestimate the impact of what looks like being America's worst natural disaster in living memory—or its possible effects. The south-eastern corner of the United States is used to savage hurricanes blitzing its coast, leaving trails of damage which are usually followed by heroic clean-ups. Katrina was unusual not so much for her strength (a category 4 storm, one notch below Florida's 1992 Hurricane Andrew) than for the way that she endured—and festered.

The waters unleashed by Katrina rose for two days. By mid-week the governor of Louisiana had ordered the evacuation of the remaining people in New Orleans and the city's mayor was saying that the Big Easy might be uninhabitable for three months. Rather than the usual upbeat pictures of smiling Americans helping each other board up houses, there were distressing images of looters ransacking shops. Rather than springing back on to its feet after the natural onslaught, a famous American city seemed to have sunk beneath the waves.

Everybody agrees that some of this pain was inevitable. Ever since 1718, when Jean Baptiste le Moyne de Bienville, a French colonist, decided to build his settlement on a hurricane-prone patch of swampland surrounded by three huge pools of water (the Mississippi Delta, the Gulf of Mexico and Lake Pontchartrain), New Orleans has been living in nature's shadow. Some sort of reckoning was thus likely, but it was made worse by recent mistakes. The debate centres on which mistakes matter most.

Already some environmentalists are pointing, inevitably, to global warming. It would be no bad thing if the Bush administration was suddenly converted to the wisdom of a carbon tax; but the link to this week's tragedy is tenuous. Global warming may have increased the intensity of hurricanes, but that is not certain, and it has anyway not increased their number. The clearer fault lies with more local decisions: first to do with changing Louisiana's topography, and then with its preparedness for such emergencies.

For much of the 20th century the federal government tampered with the Mississippi, to help shipping and—ironically—prevent floods. In the process it destroyed some 1m acres of coastal marshland around New Orleans—something which suited property developers, but removed much of the city's natural protection against flooding. The city's system of levees, itself somewhat undermaintained, was not able to cope.

What should be done? The justification for embarking on a huge, $14 billion programme to restore the wetlands has certainly increased. But it comes with several caveats: a similar federal-state restoration programme in the Everglades has been plagued by problems and was taken over last year by Florida's governor, Jeb Bush. Much more could be done at the local level in terms of upgrading flood defences and, particularly, in forcing property developers to pay the full cost of maintaining those defences.

The other set of issues involves emergency preparedness. Too many people were still on the Gulf coast when Katrina struck; and too many of those were poor and immobile. The breakdown in law and order in New Orleans is particularly disturbing. This situation, however, is easier to criticise than to solve. How many people would favour giving the government unlimited power to evict people from their homes for what could turn out to be just another near miss? That said, the authorities plainly had too few emergency workers in place. If this was the first big test for America's Department of Homeland Security, it did not come through it particularly well.

Onwards and upwards

What about the wider effect on America's economy? Immediately after the storm, oil jumped to $70 per barrel, though it fell back after George Bush ordered the release of oil from the federal petroleum reserves to help refiners affected by the hurricane. Rumours remain of a plea to ask Americans to conserve energy to avert panic buying. Meanwhile, an array of economists talked about Katrina costing America $25 billion.

History suggests that the hurricane will have little effect on the national economy. Despite all the pictures of sinking hotels and flooded convention centres, the overall impact of natural disasters is often close to neutral: lost output (which will be large) is then compensated for by a surge in reconstruction and public spending (also large). That may be scant comfort to individual hoteliers, residents and insurers, but on a national level the economic damage will be real but limited.

The one caveat has to do with oil, or, to be more specific, petrol. The damage to the energy network of rigs, refineries and pipelines in the Gulf of Mexico has coincided with a relative shortage of gasoline. Price hikes at the pumps could spark panic buying—and that could scare America's consumers. As with the federal rescue effort, this is a test of Mr Bush's leadership. He is welcome to persuade Americans to conserve energy; but beware any talk from the president about the disaster somehow underlining his fraudulent campaign to boost America's energy security. It doesn't. The United States will remain reliant on foreign sources of energy.

If there are lessons this week to learn from the past, there will also be lessons from this week to carry forward. New Orleans is hardly the only example of America's admirable hubris. Many of its greatest man-made miracles are built on precarious natural foundations. What happened to the

Gulf coast this week, will one day happen—in a different way—to Silicon Valley, Miami, Los Angeles or any of the other places that triumphantly defy geography in one way or another. There will always be more disasters; with luck they will not catch America as unprepared as Katrina did.

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Iraq

Hope against hope

Sep 1st 2005
From The Economist print edition

Though the draft constitution has not pleased all groups, it deserves to be endorsed

AFP

Get article background

PEOPLE who said that Iraq could not get much worse learned better this week, when up to 1,000 Shia worshippers perished in a stampede on a Baghdad bridge—one not directly caused by Sunni insurgents but triggered by rumours of an impending suicide-bombing. The nature of this calamity underlines the atmosphere of fear and sectarian hatred that continues to stalk Iraq, even in the heart of its capital. And this is the atmosphere in which the politicians have meanwhile been putting the final touches to an optimistic new constitution (see article). Indeed, when they are set against the loss of life, the largest in a single episode since the war began in March 2003, the elegant ideas concocted by the politicians, safe and cut off behind the barbed-wire and barriers of the government's “green zone”, may seem almost irrelevant.

They are, however, anything but that. For many months now, it has been plain that defeating Iraq's insurgency and restoring calm to all the country's religious and ethnic groups depends at least as much on politics as on military action. And though the constitution is far from perfect, it deserves a better press than it has got so far.

After decades of tyranny, the freely elected representatives of two of Iraq's three main communities—the Shia Arabs (who number 60% of the total) and the Kurds (about a fifth) but not, alas, the Sunni Arabs (barely a fifth)—agreed to an elaborate constitutional compromise after months of bargaining. Those who speak for Iraq's largest community and those who speak for its most distinct and secession-prone minority made mutual concessions that were widely deemed fanciful even a year ago. That alone is a triumph. But it was a partial one.

Might one more twiddle do the trick?

The document's rejection by the Sunni Arabs on the drafting committee is a grave disappointment. It will make it harder to contain the Sunni-led insurgency, let alone defeat it, any time soon. But this failure does not have to be catastrophic. For one thing, the document can still be tweaked before it is put to a referendum in October, in the hope that more Sunnis will be persuaded to endorse it. For another, a growing number of Sunni clergymen have been telling their co-religionists to register to vote, albeit in order to say no to the constitution in a referendum in October. If nothing else, that may draw more Sunni Arabs into peaceful politics. And if, as is possible though not certain, a two-thirds majority of voters in at least three of Iraq's 18 provinces (ie, the predominantly Sunni Arab ones) do say no, then a general election must take place which may produce a more representative parliament—including more Sunni Arabs—than last time round, when most abstained. At which point, the constitution-drafting simply begins again. Constitutions, in places much less mangled than Iraq, do not spring into life at the click of a finger.

What is remarkable is that sectarian tensions have not, so far, spilled over into wholesale intercommunal slaughter. The extreme jihadists within the Sunni insurgency, who may have provoked the tragedy at the Baghdad bridge, want exactly that to happen. But Iraq's most influential Shia clerics, led by Grand Ayatollah Ali al-Sistani, have admirably continued to restrain their followers from indulging in all-out retribution, despite a worrying rise in tat-for-tat sectarian murders. The hope is that this week's horrifying loss of life will not drive Iraq's divided communities even further apart.

In any event, the document just published is worthy and workable. It is federal, giving the Kurds a right to wide autonomy, but is careful not to give them a mechanism for secession; at the same time, it lets other non-Kurdish provinces form autonomous regions too. “Islam”, it says, “is the official religion of the state and a basic source of legislation...No law can be passed that contradicts the undisputed laws of Islam.” But, though more Islamist in character than secular-minded Iraqis would like, it protects other religions, at least on paper. In a crafty piece of wording, it says Iraq is “part of the Islamic world and its Arab people are part of the Arab nation”—ie, the Kurds are not. It says that the dispute over the oil-rich province of Kirkuk, which the Kurds claim, should be settled after a census and by referendum before the end of 2007. It says, perhaps a bit too vaguely, that oil and gas are “owned by the Iraqi people” (ie, should not be privatised) and the revenue should be fairly distributed across the country, though provinces particularly deprived under Saddam Hussein (meaning the Shia area around Basra, in the south) should be given a bigger share for a limited period. It bans what it calls “the Saddamite Baath party”, perhaps allowing some room for Baathists who disavow Mr Hussein to rebrand themselves. The document is rather shy about women's rights; issues to do with marriage, divorce and inheritance can apparently be settled either under religious or secular law. A quarter of the members of parliament must be women.

Many Sunni Arabs object that decentralisation means the dissolution of the Iraq they once ran; they particularly dislike the idea of a “super-region” where Shias might impose their own laws and where—a growing worry—the Iranians, the Sunni Arabs' hated adversaries of old, seem to be gaining influence. Sunnis gag at the wording that lets Kurds opt out of a wider “Arab nation”, and dislike the “de-Baathification” process enshrined in the document, since so many of them found it convenient to become party members under Mr Hussein.

You can't please everyone

Tough. The Sunni Arab rejectionists are wrong—and unrealistic—on all counts. They were top dogs before; now they aren't, and nor should they be. The new Iraqis are embarking on an experiment in devolved, multi-ethnic, multi-sectarian democracy to build a fairer country than before. If the

draft can be adjusted to placate more Sunnis, so much the better. But if the Sunnis hold out en masse, their minority will be the ultimate losers, even if the American forces do rush for the exit, as they are honour-bound not to. Sensible Sunni Arabs will swallow their pride and sign up. If not, they will increase the chance of Iraq's fragmentation—just what they say they want to avoid.

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The Philippines

Besmirched

Sep 1st 2005
From The Economist print edition

By evading impeachment, Gloria Arroyo will convince no one of her probity

EPA

Get article background

IMPEACHMENTS are seldom uplifting in any democracy. The public, by and large, is looking for a fair assessment of the facts, or at least a suitably solemn ritual to restore its faith in the political system. The politicians, meanwhile, are generally howling for one another's blood. The inevitable result is further partisan rancour, and an even bigger stain on politics than that caused by the alleged offence. That is what seems to be happening in the Philippines, at any rate, where the House of Representatives is currently considering an impeachment motion against President Gloria Macapagal Arroyo.

Mrs Arroyo stands accused of rigging her election victory last year. The charge is based on a series of recordings, purportedly of calls between Mrs Arroyo and an election commissioner, in which the pair chat brightly about which public officials should tamper with the ballot, how big the margin of victory should be, and how to do all of this without getting caught. Mrs Arroyo has never denied that it is her voice on the tape, and has admitted to an ill-advised conversation with an election official, yet insists she has committed no crimes.

Just the sort of murky goings-on, you might imagine, that an even-handed impeachment could usefully illuminate. But the proceedings in the Philippine Congress are predictably partisan. The president's supporters command an overwhelming majority in the House. Although the opposition has persuaded a few to switch sides, it has not yet managed to secure the 79 votes it needs to initiate a trial in the Senate. Meanwhile the Justice Committee, also dominated by the president's allies, has thrown out all three versions of the impeachment complaint on various technical grounds. All that remains is for a full session of the House to confirm the committee's findings, in a vote to be held as soon as September 5th.

No effort has been made to get to the bottom of the allegations. Instead, the congressmen have discussed which of the three motions to pursue, whether they actually count as three different motions or as two plus an amendment, whether amendments are allowed—in short, anything but whether or not the president actually cheated. The recordings have scarcely been mentioned, on the grounds that they constitute an illegal wiretap, and so are inadmissible as evidence.

That is not the worst of it. Several congressmen claim that the president's henchmen have attempted to bribe them. The opposition is not blameless. They seemed determined to topple Mrs Arroyo from the moment she took office, thereby casting doubt on all the “scandals” they have subsequently unearthed. The notion that they might have doctored innocent recordings to incriminate the president does not, sadly, seem impossibly far-fetched.

Yet there is still time to get to the truth. The opposition says it is only six votes short of the magic 79. Mrs Arroyo says she would welcome a thorough airing of the charges against her to clear her name. If she is sincere, her allies in Congress could easily grant her wish. Whatever Congress decides, Mrs Arroyo herself could always give the public—to whom she (probably) owes her job—a fuller account of her “lapse of judgment” than the terse statement she has yielded so far.

If Mrs Arroyo is innocent, it is hard to understand why she is keeping so quiet, and allowing the current whitewash. But puzzled Filipinos will have little recourse until the next election, when they can at least kick out all these rascals—provided, of course, that the vote is not rigged.

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If, at first

Sep 1st 2005
From The Economist print edition

Will the latest cycle of European mergers produce better results?

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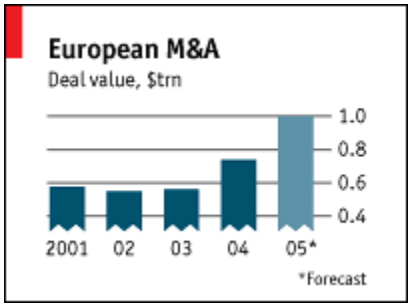

COMPANIES have embarked on what looks like the beginnings of a re-run of the mergers and acquisitions (M&A) wave that defined the second bubbly half of the 1990s. That period, readers might recall, was characterised by a collective splurge that saw the creation of some of the most indebted companies in history, many of which later went bankrupt or were themselves broken up. Wild bidding for telecoms, internet and media assets, not to mention the madness that was Daimler's $40 billion motoring takeover in 1998-99 of Chrysler or the Time-Warner/AOL mega-merger in 2000, helped to give mergers a thoroughly bad name. A consensus emerged that M&A was a great way for investment banks to reap rich fees, and a sure way for ambitious managers to betray investors by trashing the value of their shares.

Now M&A is back. Its return is a global phenomenon, but it is perhaps most striking in Europe, where so far this year there has been a stream of deals worth more than $600 billion in total, around 40% higher than in the same period of 2004 (see article). The latest effort came this week when France's Saint-Gobain, a building-materials firm, unveiled the details of its £3.6 billion ($6.5 billion) hostile bid for BPB, a British rival. In the first half of the year, cross-border activity was up three-fold over the same period last year. Even France Telecom, which was left almost bankrupt at the end of the last merger wave, recently bought Amena, a Spanish mobile operator.

Shareholders' approval of all these deals raises an interesting question for companies everywhere: are investors right to think that these mergers are more likely to succeed than earlier ones? There are two answers. The first is that past mergers may have been judged too harshly. The second is that the present rash of European deals does look more rational, but—and the caveat is crucial—only so far. The pattern may not hold.

M&A's poor reputation stems not only from the string of spectacular failures in the 1990s, but also from studies that showed value destruction for acquiring shareholders in 80% of deals. But more recent studies by economists have introduced a note of caution. Investors should look at the number of deals that succeed or fail (typically measured by the impact on the share price), rather than (as you might think) weighing them by size. For example, no one doubts that the Daimler-Chrysler merger destroyed value. The combined market value of the two firms is still below that of Daimler alone before the deal. This single deal accounted for half of all German M&A activity by value in 1998 and 1999, and probably dominated people's thinking about mergers to the same degree. Throw in a few other such monsters and it is no wonder that broad studies have tended to find that mergers are a bad idea. The true picture is more complicated.

Of course, it's different this time

Several factors suggest that European companies, in common with their counterparts elsewhere, are not being reckless in the latest round of deals. Importantly, some of the features of the bubble years have disappeared or become less influential. For example, managers are less loaded up with share options, which has reduced their temptation to chase deals that deliver a short-term pay-off at the cost of long-term value creation. Companies also seem more intent this time on strategic, rather than financially motivated deals—building on core strengths and buying into new geographic markets are common themes in the latest round of deals, whereas costly diversifications are little in evidence. In addition, a bigger proportion of deals are being paid for in cash, a currency which managers tend to harbour more prudently than shares and which is a less forgiving measuring rod.

And finally, as labour-market and other reforms (however modest) in Europe have slowly eased the way towards a genuine single market, firms are understandably focusing on building a stronger pan-European competitive position. Sometimes the best way to do this is through mergers.

However, there are also good reasons to be wary. The latest deals may seem more targeted and strategic, and therefore better justified, than many in the 1990s. But most merger waves begin in this sensible way before spiralling out of control. The recent growth of hedge funds and private-equity firms means that there are many more potential bidders for any target company. Private equity, in particular, is a potent competitor capable of pushing up prices for a company looking for a strategic merger. And cash, today's currency of choice, is a remarkably cheap commodity thanks to low interest rates and abundant liquidity. In other words, the ingredients for excess exist. Paying too much for a reputation-enhancing acquisition or headline-grabbing takeover remains an ever-present danger for anyone at the top of a big company.

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Economist.com OPINION

Digital living

The home of the future

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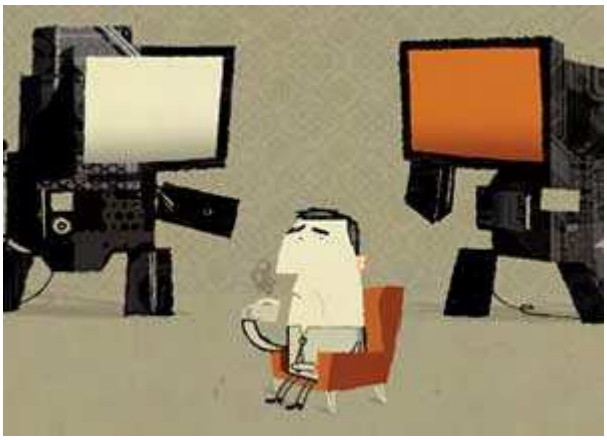
Most people will never turn their homes into electronic control centres



THE Californian coastline north and south of Silicon Valley is a trend-setting sort of place. Increasingly, the home interiors of the well-heeled there tend toward one of two extremes. Houses are either light-flooded, sparse and vaguely Asian in character, with perhaps a Zen fountain in one corner, a Yoga area in another. Or they resemble electronic control rooms with all sorts of gadgets, computers, routers, antennae, screens and remote controls. Occasionally, both elements are present. “She” may have the living room and public areas, while “he” is banished with his toys up or down the stairs.

Currently, the gadget lovers have powerful allies. Many of the largest companies in the consumer-electronics, computer, telecoms and internet industries have made a strategic decision to hawk visions of a “digital home”, “eHome”, or “connected home” (see article). Doubting that demand from corporate customers will ever recover to the boom levels of the late 1990s, Microsoft, Intel, Sony, Verizon, Comcast, Hewlett-Packard, Apple and others see the consumer as their best chance for growth and will be throwing a bewildering array of home “solutions” at him in the coming months and years.

To understand what the vendors ultimately have in mind it is best to visit the mock homes that most have built on their campuses or at trade shows. Rarely cosy and often intimidating, these feature flat screens almost everywhere, from the large TV-substitute in the living room to electronic picture frames in the bedroom. Every object has a microchip and can be talked to, typed into or clicked onto. Everything is connected to a central computer through wireless links.

At last, the solution to sour milk

Under the supervision of the company-trained tour guide, these objects perform feats that fall into

two categories: automation and entertainment. Among the things automated are the opening and closing of garage doors, the re-ordering of groceries (invariably milk, for some reason) in the refrigerator, the locking and unlocking of doors, and so on. In the entertainment category, the demonstration usually includes movies, songs or photographs hopping from screen to screen and room to room as the visitor moves. Everything fun ever produced, it is implied, is there at the touch of a button. How could one possibly be sceptical?

Quite easily, in fact. The technorati may disagree, but a lot of their fantasies are not all that new, and have repeatedly failed in the real world. The dream of super-gadgets that can do anything dates back at least to the early 20th century. The Sears catalogue in those days was full of what would today be called “converged” devices—a food processor doubling as a pleasure vibrator for women; a vacuum cleaner that also dried hair, heated rooms and spray-painted walls; a washing machine that also beat eggs and minced meat. Few of these devices ever made it out of the catalogue and into homes.

Why not? Because convergence usually goes against the grain of human nature. A converged device is invariably complex, and people like simplicity. A converged device represents a single point of failure, and people like to know that they can still look at baby photos even if the TV breaks down.

The digital-home technorati boldly beg to differ. Their visions are predicated, yes, on specialised devices as “spokes” around the house, but also on all of these spokes connecting to one central “hub”. Their disagreements, which are passionate, are only about whose box and whose technology should constitute that hub, with Microsoft, Intel and computer makers pushing the PC, the telecoms and cable operators lobbying for their proprietary set-top boxes, and the consumer-electronics makers fighting for their consoles, TV sets or digital-video recorders. Collectively, they seem unbothered that the few instances of converged super-gadgets that already exist, such as the so-called “media-centre PC”, have been utter failures.

That intransigence is a pity because not all parts of their vision are ridiculous. Downloading entertainment (as opposed to buying it on physical discs) is convenient, and if consumers were confident that such “content” could play on any sort of device, they might do a lot more of it. But this is not the case, because each company is also aiming to recreate the sort of dominance that Microsoft achieved in the PC era by anointing its own technology as the universal standard, reducing other firms to royalty-paying serfs. Thus each is refusing to bring its own standards into harmony with those of rivals.

For consumers, this means economic risk (if they bet on a technology that goes extinct) or lots of fiddling with manuals full of gibberish. Admittedly, at least around Silicon Valley, there are people (mostly men) who quite like the sound of this. They, however, tend to live near, or even with, other Californians (mostly women) whose Feng Shui consultants are vehemently opposed to it. *The Economist* reckons the latter will gain the upper hand.

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Israel's leadership

Why Arik is better than Bibi

Sep 1st 2005
From The Economist print edition

Yes, there's a difference

AP

EVER since Ariel Sharon said he would pull all of Israel's settlers and soldiers out of the Gaza strip, the smart response of too many of Israel's critics abroad has been to belittle this decision. First they said it wouldn't happen. Then, when it happened, they said it was just a ruse, a concocted trauma designed to ensure that Israel could cling forever to the West Bank. But for Israel itself, and for its prime minister, evacuating Gaza has indeed been both painful and fateful. And it now looks quite possible that Mr Sharon will lose his job for it.

Leaving Gaza was popular with most Israelis. So is Mr Sharon. But to many members of the ruling Likud party it looked like a retreat in the face of terrorism and a betrayal of the settlers by the very man who did most to build them up. That is why Binyamin ("Bibi") Netanyahu, who said this week that he would campaign to wrest the party leadership from Mr Sharon, stands a reasonable chance. Polls suggest that he has far more votes than Mr Sharon among party members, who will have to vote in primaries to choose their leader before the next general election, due by November 2006. Whether he can then become prime minister depends on the two men's skills at brinkmanship (see article).

All this is fascinating to Israelis. But why should Palestinians, let alone outsiders, care which man wins? Both probably share the same vision about the sort of peace they would be willing to make with the Palestinians. Neither wants to give up an acre more land than they have to on the West Bank; both would oppose the return to Israel proper of the Palestinian refugees of 1948; and both will insist on Israeli sovereignty over Jerusalem. On the other hand, like most of Israel's political establishment, including much of Likud, both are realists: they know that the minimum price of peace with the Palestinians is deep territorial compromise. Even Israel's controversial "security barrier", which the Palestinians call a land grab, would if it became a political border give it only about 11% (still, perhaps, too much) of the West Bank, leaving more than 50,000 settlers on the

“wrong” side facing evacuation.

As to their personal qualities, it is safe to say that neither would win a popularity contest among Palestinians. Mr Sharon has spent a lifetime fighting against the idea of Palestinian statehood and is said to question still whether a safe, final peace will be possible for generations. Bibi is more plainly an opportunist—he has made a career of it—so might be expected to be more pliant in some eventual negotiation. He is also younger, and more energetic.

It's not who they are; it's where they stand

All the same, those who hope for a peace breakthrough should hope that it is Mr Sharon, not Mr Netanyahu, who becomes prime minister next time Israel goes to the polls (the chances of a Labour victory are, alas, fairly negligible). This is not because of some fundamental difference of vision or character between the two men. It is because of where each has chosen to take his stand in this contest.

To unseat the prime minister, Bibi has thrown in his lot with the least flexible elements of Likud—the bitter-enders who cling to the nonsensical idea that Israel can remain a Jewish democracy while ruling over millions of Palestinians. If he wins power with their support, he will find it extremely difficult to change position afterwards. Mr Sharon, in contrast, has just shown most dramatically in Gaza that he has the temerity to challenge and defeat this bunch, even if it means betraying those who previously lionised him. If the first Israeli leader to take such a risk is rewarded with the boot, peace with the Palestinians will remain as elusive as ever.

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Letters

Sep 1st 2005
From The Economist print edition

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Niger's information gap

SIR – Three million people in Niger are still at risk from starvation because of a failure in local information systems ("Starving for the cameras", August 20th). The relief agencies and the government decided months ago on a subsidised, rather than free, food distribution programme to minimise market disruption, yet there was no independent method of tracking market prices to see if the policy worked. Niger's physical infrastructure is bad, but mobile phone and radio coverage is good and this breakdown could have been avoided.

Moreover, Niger's local journalists say they still have only sporadic contact with the relief effort. One aspect of the scramble for funds is that relief agencies are told to get the CNN or BBC team to their feeding centre, rather than work with the local media. Logisticians therefore have to rely on word of mouth from secretive networks of local officials to publicise food distribution and for feedback on how the system is working.

A system which links the relief effort to local media is needed now to provide news to distressed populations. No one questions the need for media to channel continual public communication and debate as part of good governance in the West, despite the occasional risks of sensationalism and bias. Niger is a fledgling democracy with a vibrant, free media—why should we assume the human dynamics are any different?

John West
Internews Europe
Paris

Measuring Germany

SIR – I am disappointed about your short-sighted analysis of the German economy ("Ready to motor?", August 20th). While it may be true that corporate Germany has become more competitive by replacing labour through capital, redeploying human resources efficiently and slashing its costs, the surprising "success" has come at a high price: 5m unemployed. Moreover, German unemployment is notably a problem for unskilled workers who have been replaced by outsourcing and technology, so your reference to "unit labour costs" when measuring Germany's competitiveness with other European countries is too simplistic. As product costs include mainly capital and labour, and the capital costs for companies are nearly the same in every country, the real differences are in wages. So the more important indicators to measure are growth and the unemployment rate. The latter shows signs of improvements for skilled workers. However, even growth will not alter the situation for the unskilled because wages will stay comparatively high. Germany's reform programme, Agenda 2010 is welcome, but it does not solve the core of Germany's ills: unemployment.

Andreas Eggert
Hamburg

SIR – One of the drawings in your report shows a car heading in the wrong direction on the left side of the autobahn. Does this reflect your British origins, or are you not so convinced after all that Germany is heading the right way?

Harald Meilicke
Dusseldorf

SIR – Freud would have loved your cartoon. The motorist, who appears to symbolise the German economy picking up speed, must be a *Geisterfahrer*. Tearing along the wrong side of the road, he is heading for the mother of all collisions.

Hans Heinrich Thias
Bradenton, Florida

It takes a village

SIR – Operating costs are indeed the biggest challenge for microcredit lenders in India and a much bigger impetus in the economics of the business than bad-debt charges ("Helping themselves", August 13th). You suggest that investing in IT in "back-office" efficiencies can alleviate this problem. However, most of the operating costs are to be found in the front end of the business—in the villages. Given the heterogeneity of borrowers, credit officers have to get out and about in order to understand the businesses they are lending to (as of yet, lenders cannot rely on scoring models that adequately capture the full complexity of their clients). Moreover, a visual inspection of the actual business and background checks with neighbours, for instance, are key inputs in the assessment of creditworthiness. Technology can play a large role in making microcredit more accessible, but in the near future, pay-offs will come from work done in the field.

Pieter Lekkerkerk
Amsterdam

Property valuations

SIR – You state that the Supreme Court has given the United States government power to bulldoze homes on flimsy grounds ("Hands off our homes", August 20th). This repeats a common error made in the American press. The court gave no such power. The power, where it exists, has been granted by state and federal legislatures. What the Supreme Court decided was that the constitution does not forbid such bulldozing. Congress, state legislatures, and even municipalities can forbid the practice if they so choose.

Peter Lushing
Benjamin N. Cardozo
School of Law
New York

SIR – Please come to New London and show us those "perfectly nice waterfront homes" you describe. What you're absolutely certain to find is the sewage plant that is this inner city slum's major landmark, which still reeks even after millions have been spent on smell abatement. We New Londoners are as concerned as everyone else about the potential abuses of eminent domain proceedings running amok. But we're also concerned about the municipal-budget squeeze that is ruining our schools and eliminating vital services. Many of us thought that the redevelopment plan

approved by the Supreme Court was a fair way for all concerned of increasing the tax base. But with one-sided reporting like yours, we're probably out of luck.

Wayne Muller
New London, Connecticut

SIR – Anyone who forces the taking of a property should pay twice the fair market value, making most buyers think twice before they use eminent domain as a way of creating a good financial deal for themselves.

Tom Holze
Boston

Britain's tolerant society

SIR – Your arguments against the British government's anti-terrorism proposals are off the mark ("Dealing with traitors", August 13th). I would suggest that the heart of the issue is tolerance, not free speech. Extremist teachers are a threat because they spread ideas and doctrines that convince some that the members of a given society are so evil or lowly that their lives are of no consequence. It is perhaps ironic, but in order to defend the British culture of tolerance the government must limit how much they tolerate the spread of excessive intolerance.

Mark Wilger
Shekou, China

Love and hate

SIR – Taking a "kidney-rattling" ride in a London taxi is like eating Marmite: you don't need to be British to enjoy it, but that surely helps (Letters, August 20th).

Martin Gargiulo
Singapore

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Economist.com SPECIAL

America and China

The dragon comes calling

Sep 1st 2005 | BEIJING AND WASHINGTON, DC
From The Economist print edition

No bilateral relationship is more important than America's and China's. Yet as George Bush and Hu Jintao prepare to meet, it is in a fractious state

IN 1979 China's late leader, Deng Xiaoping, impressed many Americans by donning a Stetson at a rodeo in Texas. The impromptu gesture was taken as a sign that China was at last ditching Maoism and fervent anti-Americanism, including distaste for its “bourgeois” line in hats. America was to be its new friend in the cold war with the Soviet Union. In Washington next week, on his first visit since he took over as Communist Party chief in 2002, President Hu Jintao will try to convince Americans that China is still a friend and that its growing economic and military power is nothing to worry about. He will have a far tougher time of it.

Some of Mr Hu's handicaps are personal. Foreign affairs are still a bit of a maze to him, and he knew little of them before he assumed the leadership. Nor does he seem to have hit it off with President George Bush, though they have met several times elsewhere. He remains an enigmatic figure, with none of Deng's crowd-pleasing ways. Diplomats say he prefers to stick closely to his brief.

Relations, besides, are so tricky just now that the two sides cannot even agree on how to describe the visit. Rather than accept Mr Bush's invitation to hold informal talks at his ranch in Crawford, Texas, Mr Hu chose a more formal reception at the White House, presumably hoping it would boost his image as a statesman at home. But the Americans have refused to glorify the trip by calling it a “state visit”, the term Chinese officials use. Mr Hu will get a 21-gun salute, but not a state dinner in the evening. These niceties may sound inconsequential, but they send a clear signal that all is not well.

And the reasons are not hard to see. In recent months, China-bashers have emerged all across

the American political spectrum. On the left, the unions think that China's harsh labour conditions are a form of unfair competition that destroys American jobs. On the right, defence hawks feel threatened by China's accelerating military build-up, not to mention its record of supplying arms to pariahs. Congress recently assumed that a Chinese bid for a middling American oil firm might mark the beginning of an attempt to “buy up America” and imperil its security. Mr Bush's Christian supporters look askance at an atheist dictatorship that persecutes Christians. And it would be hard to find an American who is not repelled by, for example, Chinese officials' habit of persecuting those who exceed birth quotas.

As China sees it, America's current Sinophobia is beginning to rival its preoccupation with terrorism. Bush administration hawks who had fallen silent on China—of whom the defence secretary, Donald Rumsfeld, looms largest in Chinese minds—are beginning to take up the cudgels again. China now frets that its professed willingness to help fight global terrorism and resolve the nuclear crisis in North Korea is of limited value in keeping Americans happy. America's trade deficit with China, which has almost doubled in the past four years (see chart), has compounded the problem. China's fear is that tensions could grow, jeopardising its access to its biggest overseas market and fuelling military rivalry, too. Small wonder that Mr Hu will not be treated to White House consommé and crystalware.

The great free-trade war

On the trade front, the two countries' interests are mostly identical. Both would benefit from free trade. But China exports six times as much to America as it imports from it. After many years of American hammering for better access to China's market, it is now the Chinese who are on the free-trade offensive.

Talks in Beijing this week between American and Chinese officials produced no progress in their dispute over a massive surge in China's textile exports to America. On September 1st, America decided to restrict imports of Chinese-made bras and some synthetic fabrics. Chinese textile imports have risen by 97% in the six months since quotas were lifted, in January. An editorial this week in the official *China Daily* newspaper declared that America's textile industry, instead of seeking protectionist measures, should instead embrace “restructuring”—for which read the further migration of manufacturing to countries such as China.

Many Americans assume that the Chinese are not playing fair. In fact, China's economy is

relatively open by developing-country standards. For a long time, the yuan was undervalued in what seemed, to American officials, a deliberate attempt by China to make its exports more competitive. After persistent complaints from both America and Europe, China adjusted its currency-exchange policy in July, allowing the yuan to strengthen by 2%. But the adjustment is still too small to make much of a dent in the deficit, and the Americans want more. Minxin Pei of the Carnegie Endowment for International Peace, a think-tank, predicts that “things will get ugly next year”. And although Mr Hu will ask Mr Bush to treat China as a market economy under American trade law, which would make it harder to slap anti-dumping measures on Chinese goods, his request is unlikely to be granted.

There are some brighter spots. In Seattle, where Mr Hu is due to meet business leaders, there will be praise for China's confirmation in August of a $5 billion order for 42 Boeing 787 Dreamliner jets. This was a big show of support for the new model, which is being made in Seattle and is seen by Boeing as crucial to the company's future development. But China's common tactic of winning friends abroad with aircraft orders will not impress America's disgruntled workers, at least outside the north-west.

Another hot economic issue is China's galloping demand for energy, which is one reason why oil prices are so high. (The other big one is American demand.) Because petrol is so lightly taxed in America, motorists there are hurt more by oil-price rises. They want someone to blame, and they may have heard that China is scouring the world to lock up oil supplies for its own “energy security”.

In June, CNOOC, a Chinese state-controlled corporation, tried to buy Unocal, a middling-sized American oil firm. Security hawks were horrified that such a strategic asset might fall into potentially hostile hands. So were 73% of the American public, according to one poll, and the House of Representatives, which voted 398 to 15 to urge a presidential “review” of the bid. CNOOC took the hint and withdrew.

Free-traders were outraged. James Dorn of the Cato Institute, a libertarian think-tank, scoffed at the idea that the bid for Unocal, whose American oil wells account for only 1% of American consumption, might affect national security. Others noted that China might reasonably conclude from the episode that it cannot rely on global trade rules to secure its energy supplies, and should look instead to mercantilist or even military means to do so. Mr Bush will try to convince Mr Hu that this is not true, but Congress has undermined his case.

General Zhu's bombshell

American defence planners also view China's rise with apprehension. Here is a nasty authoritarian regime with a rapidly modernising army far larger than its defensive needs require. As China gets richer, it can pay for more and smarter weapons, some of the scariest of which (more than 700 short-range ballistic missiles) it is placing near the Taiwan strait. A recent Pentagon review noted that “China does not now face a direct threat from another nation. Yet, it continues to invest heavily in its military, particularly in programmes designed to improve power projection.” The review added that current trends in military modernisation could pose “a credible threat to modern militaries operating in the region”. Such as America's.

A flurry of books and magazine articles boast titles such as “China: The Gathering Threat” and “How We Would Fight China”. Several weeks ago, a Chinese general, Zhu Chenghu, threatened that China would lob nuclear weapons at “hundreds” of American cities if the two countries came to blows over Taiwan. Chinese generals often make such incendiary remarks, and are rarely punished for it.

In fact, war between China and America is neither imminent nor likely. General Zhu's nuclear bombshell does not reflect official policy, as the Chinese foreign ministry stressed shortly after he dropped it. Tensions over Taiwan have cooled since last December's legislative elections there, and Mr Bush will reassure Mr Hu that America still has a “one China” policy. But America is also committed to helping Taiwan defend itself if it is attacked by the mainland, and China on September 1st issued a warning that “relevant countries” should not think of protecting Taiwan with a missile-defence system. Mr Hu and other Chinese leaders believe that stronger Chinese armed forces, with a capability to attack American forces if necessary, are essential to deterring Taiwan from moving to formal independence.

Both sides, wary of the other's strength, are seeking to strengthen regional alliances: America by schmoozing India and persuading Japan to be more assertive, China by cosying up to Russia and the Central Asian states.

In August, Russia and China staged their first joint military manoeuvres. They strenuously denied that these were aimed at any third country, and tactfully called the 10,000-man exercise in eastern China an anti-terrorist operation. But it is hard to believe that a message to America was not implied. Both countries are members of the Shanghai Co-operation Organisation, a grouping of Central Asian nations that both China and Russia have been nurturing (with limited success) as a counterbalance to America's influence in the region.

The Americans are unlikely to be unduly worried. They know that Russia has its own anxieties about China's rising power, and that China and Russia both regard their ties with America as considerably more important than China-Russia relations. More disturbing to the Americans are Russia's efforts to profit from China's demand for sophisticated arms. Russia is China's biggest foreign arms supplier. At the recent exercises it deployed strategic bombers, which military experts say China would like to buy as part of its preparations for possible conflict with America over Taiwan.

America and China are in harmony on one subject: both agree that North Korea is a menace. The two governments are working together to try to persuade Kim Jong Il, the North Korean despot, to give up the nuclear weapons that he claims—and most observers believe—he has. An American official close to the stop-go six-party talks (including America, China, both Koreas, Russia and Japan) on this issue says that China has been “very helpful”.

But China and America have different priorities. For America, disarming North Korea is the top goal. For China, that comes second to making sure that North Korea does not collapse and unleash even more refugees into China than it has already done. This is perhaps why the government in Beijing has not used all the levers at its disposal. Although it could shut off North Korea's oil supplies, it has only done so once, for three days in 2003.

Almost every aspect of Sino-American relations is complicated by the fact that only one of the two powers is a democracy. To take a small example, America is holding a handful of Uighurs it captured in Afghanistan. It wants to release them, but cannot hand them over to China. The Uighurs, Muslim separatists in the far western province of Xinjiang, are often involved in violence against the Chinese state. Chinese officials are already furious about the establishment last year in America of a Uighur government-in-exile. For all these reasons, as well as China's rickety justice system, there is no hope that the Uighur prisoners would get a fair trial there.

Mr Hu is not about to give ground on any human-rights issues. He has shown no eagerness to promote political reforms at a time of growing social turbulence caused by rapid economic change. Chinese officials have accused the Americans of instigating the revolutions in Georgia, Ukraine and, most worryingly for China, neighbouring Kirgizstan during the past two years. Mr Hu will dismiss out of hand any suggestion by his American hosts that China should embrace democracy

too.

Since last year, China has refused to talk to America about human rights, in protest against America's decision to sponsor an abortive attempt to have China censured at the UN Human Rights Commission in Geneva. In December China's top policeman, Zhou Yongkang, gave warning of growing social unrest and urged police officers to put a stop to any organised dissent. He accused foreign religious groups, including American Christians, of stepping up their activities in China, including a “new trend” of “infiltrating” universities and government departments.

China doubtless feels secure in its belief that the Bush administration, like others before it, will not allow human rights to make or break the relationship. To defuse tensions over this and the host of other contentious issues, Mr Hu is likely to use his public appearances—including a speech at Mr Bush's alma mater, Yale—to put a positive spin on the relationship. The message, according to a Chinese diplomat, will be that “China is a force for peace and that China's development is peaceful in nature”. Such protestations will be greeted with scepticism.

Grounds for hope

The biggest danger to the relationship is not so much the lack of warmth between Mr Bush and Mr Hu. Both governments, despite misgivings about each other's policies, appear to recognise that they have enormous stakes in each other's continuing prosperity. Reluctant though it is to say so publicly, China even sees certain benefits in a Pax Americana, particularly in north-east Asia, where it worries about a resurgence of Japanese military power if the Americans retreat.

But China's economic rise has been accompanied by the growth of an increasingly vocal, occasionally virulent, nationalism. Mr Hu sometimes feels obliged to make concessions to this, as when the leadership tolerated, for a time, the widespread anti-Japanese protests earlier this year. The control of China by an authoritarian and secretive Communist Party (attributes which Mr Hu unwisely fosters) fuels this xenophobia in China, as well as American wariness.

Chinese officials, confused by the change of American mood from the rodeo-and-Stetson days, like to see the problem as one of presentation. During a visit to America in 2003, China's prime minister, Wen Jiabao, used the term “peaceful rise” to describe China's growth. But Chinese leaders later backed away from the phrase. Hardliners felt it limited China's options for handling Taiwan, and liberals felt that even the word “rise” was too provocative. Jia Qingguo of Peking University says both governments need to encourage positive thinking among their publics. But he cautions that “China can only do so much. Americans have to reassure themselves.”

How might they do so? In the long term, there are three reasons why the “China threat” may be overstated. One is that, unlike the American government, Osama bin Laden or the old Soviet Union, China's ruling party is not trying to spread an ideology. It has none to spread.

In a narrow sense, of course, it offers a rival to the American-sponsored liberal-democratic model; China has shown that a country can prosper, at least in the short term, by allowing economic freedom but not the political sort. And its needs for energy and raw materials can prompt it, Soviet-style, to back pariah states such as Sudan and Iran. But for all the talk of revolutionary solidarity, China's leaders recently decided not to extend a regime-saving loan package to Zimbabwe's tyrant, Robert Mugabe, for the pragmatic reason that he has a terrible credit history.

The second reason for calm is that, as Adam Segal of the Council on Foreign Relations puts it, China's economic reforms may spur democratic ones. There is plenty of domestic pressure for change, though only at low levels: the Chinese government counted 74,000 protests last year, mostly against local misrule. A more democratic China might not be nicer: it could be unpleasantly

nationalist. “Ultimately China will find its own way politically,” says a senior American official. “How it does so will depend in part on how we shape them. The consensus is we need to be engaged. We want them to grow in a rules-based way.”

The third reason not to panic is that China's economic explosion cannot continue for ever, not least because the one-child policy has probably doomed China to grow old before it gets rich. A hard landing for the Chinese economy would harm the rest of the world in many ways, but it would ease fears that the next superpower will be a dictatorship.

America has agonised before over the emergence of an Asian rival whose unfair trade practices, gluttony for raw materials and ruthless nationalism were thrusting the two countries towards a collision. That was the argument of “The Coming War with Japan”, a book that was taken seriously when it was published in 1991. The unstoppable Japanese economic juggernaut, you may recall, stalled around the time “The Coming War” came out. In a decade or two, will the widespread current fear of China seem as laughable as the Japanophobia of yore?

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Hurricane Katrina

After the flood

Sep 1st 2005 | NEW ORLEANS, NEW YORK AND WASHINGTON, DC
From The Economist print edition

AP

Hurricane Katrina has devastated New Orleans. Picking up the pieces will not be cheap or easy

“WHAT I saw today is equivalent to what I saw flying over the tsunami in Indonesia. There are places that are no longer there.” That is how Mary Landrieu, one of Louisiana's senators, described the scenes she saw below her on August 30th. She was flying by helicopter over the aftermath of Hurricane Katrina, a devastating hurricane that had swept in from the Gulf of Mexico. The storm hit land near New Orleans on August 29th at a speed of some 145mph, and then went on to pummel parts of Mississippi before ultimately fading further north.

Though not on the vast scale of the tsunami, the human and economic costs of Katrina are serious and still mounting. The mayor of New Orleans, Ray Nagin, thinks the death toll will be “minimum hundreds, most likely thousands”. Tens of thousands have been displaced. “This recovery will take a long time”, George Bush warned the nation after he flew over the carnage. “This recovery will take years.”

Unlike most hurricanes, which are over in a relatively brief burst of fury, this one continued to get worse. For two days after the storm had passed, floodwaters continued to rise around the Big Easy. Those waters swept away the joy of many who thought they had narrowly escaped. The floods brought with them poisonous snakes, water-borne diseases and the grotesque carcasses of dead neighbours and abandoned pets.

It was unclear when the waters would recede, never mind when life would return to normal. Power may not be restored for weeks. Looting, too, began to spiral out of control. Mr Nagin, who said the city might be uninhabitable for three months, was forced to order police to concentrate on

stopping crime, not saving people.

Already a series of questions appear behind the tragedy. What is the cost to the area and the national economy? What can be done with the displaced people? But begin with the one that matters most: was part of this unfolding tragedy preventable?

Of course, hurricanes themselves are not preventable. Though global warming may increase the intensity of storms like hurricanes, abandoning fossil fuels in favour of windmills and bicycles would not make the world safe from cyclones. Historical records show that hurricanes were devastating the coast of the Gulf of Mexico long before sport-utility vehicles ever hit America's roads.

Experts have stressed for quite some time that New Orleans is exceptionally vulnerable to a killer storm such as Hurricane Katrina. Fred Caver, of the Army Corps of Engineers, recently urged officials to shore up their defences: “You're living on borrowed time today. You have until the next big storm zeroes in on coastal Louisiana directly.” There is an irony, however, in this warning coming from the Corps of Engineers. Just as with the Everglades in Florida, New Orleans's vulnerability has been exacerbated by the corps' excellence in reshaping nature's waterways to suit mankind's whims. In the middle of the last century, engineers succeeded in re-plumbing the great Mississippi river to make shipping easier and to control floods.

Alas, those same measures also hastened erosion of the coastal marshes that used to buffer New Orleans, leaving the city needlessly exposed. Most of the metropolitan area lies below sea level on drained swamp land. Levees normally hold back the Mississippi and Lake Pontchartrain, but those were not designed to handle the waters that would come with such a powerful hurricane.

America's Geological Survey has estimated that if nothing is done by 2050, Louisiana will lose another 700 square miles of coastal wetlands. Various local groups have long called for reconstruction of the marshes along the lines of the troubled $10 billion Everglades rejuvenation project. The New Orleans version, which would cost $4 billion more, would divert some 200,000 cubic feet of water each second from the Mississippi 60 miles through a channel to feed the existing marsh and to build two new deltas. The plan, which would also shut canals and locks to keep out salt water and would build artificial barrier islands, may find more adherents.

Even if New Orleans had not been protected by such a grand scheme, it seems that much more could have been done to make the city a little less vulnerable to water and wind. When Hurricane Katrina made landfall, it flooded the streets, ruined the power grid, tore roofs and walls off historic

buildings and brought down many of the majestic trees that provide shade in the scorching summer weather.

Hurricane Katrina's path cut just to the east of New Orleans at the last minute, thereby sparing the city the storm's most intense winds and rain. The immediate effects were devastating in coastal cities to the east, such as Gulfport, Mississippi. Early reports suggested that 100 or more had died in Biloxi, Mississippi. The number of dead in and around New Orleans is as yet undetermined, but one thing is sure: the suffering is likely to continue for some time, because the city is uniquely ill-equipped to withstand a severe hurricane.

The region was probably not helped by planning regulations either. Put simply, too many homes on the Gulf coast have been built in areas that are susceptible to flooding; and the developers who put them up did not contribute enough to flood-control systems. In most other catastrophes of this sort, there is usually a paper trail of building permits given rather too easily by local authorities to favoured builders. It is hard to believe that the Big Easy—no stranger to political graft—will be any different.

Looters and more

Hurricane Katrina may also have torn a breach in the city's fragile social fabric. It was notable that many of those left behind in the city were from its poorest neighbourhoods; notable too that those poor neighbourhoods were among those worst hit by the storm. (And the same could be said for many of the other communities farther up the coast.)

Even before the storm had passed, there were sporadic reports of looting. In one flooded area inaccessible to police, thieves pulled a boat through waist-deep water toward a convenience store, and then went in to raid the shelves. At a Wal-Mart Super Centre the next day, an apparent attempt by government agencies to get essential supplies turned into a free-for-all. Residents of surrounding neighbourhoods streamed to the store to cart off food, water and nappies—but also DVD players, computers, refrigerators and guns. Some police officers stood powerlessly, while others appeared to be helping themselves to TVs. “The police were in there with us,” gloated one man as he pushed a loaded trolley up Tchoupitoulas Street.

Worries about looting, as well as health dangers arising from fallen power lines and sewage-filled water, prompted Louisiana's governor Kathleen Blanco to order the mandatory evacuation of people stranded in New Orleans. Some 25,000 of them were inside the Superdome, a football stadium with a roof (albeit a leaky one). Texas has now begun to take some of them by bus to Houston's Astrodome.

The after math

As the human tragedy wrought by Katrina became depressingly clear, the hurricane's economic consequences remained uncertain. Instant estimates from insurers suggested the storm had caused insured damage worth around $26 billion. That would make it the industry's single most serious event since the attacks of September 2001, and make it more costly than Hurricane Andrew, which hit Florida in 1992. As usual, reinsurers may end up taking the hardest hits. Swiss Re, the world's second-largest reinsurer, has put its estimated exposure at about $500m.

The broader question is what impact, if any, Katrina will have on America's overall economy. History suggests not much. Hurricanes—even big and expensive ones, such as Andrew or

AP

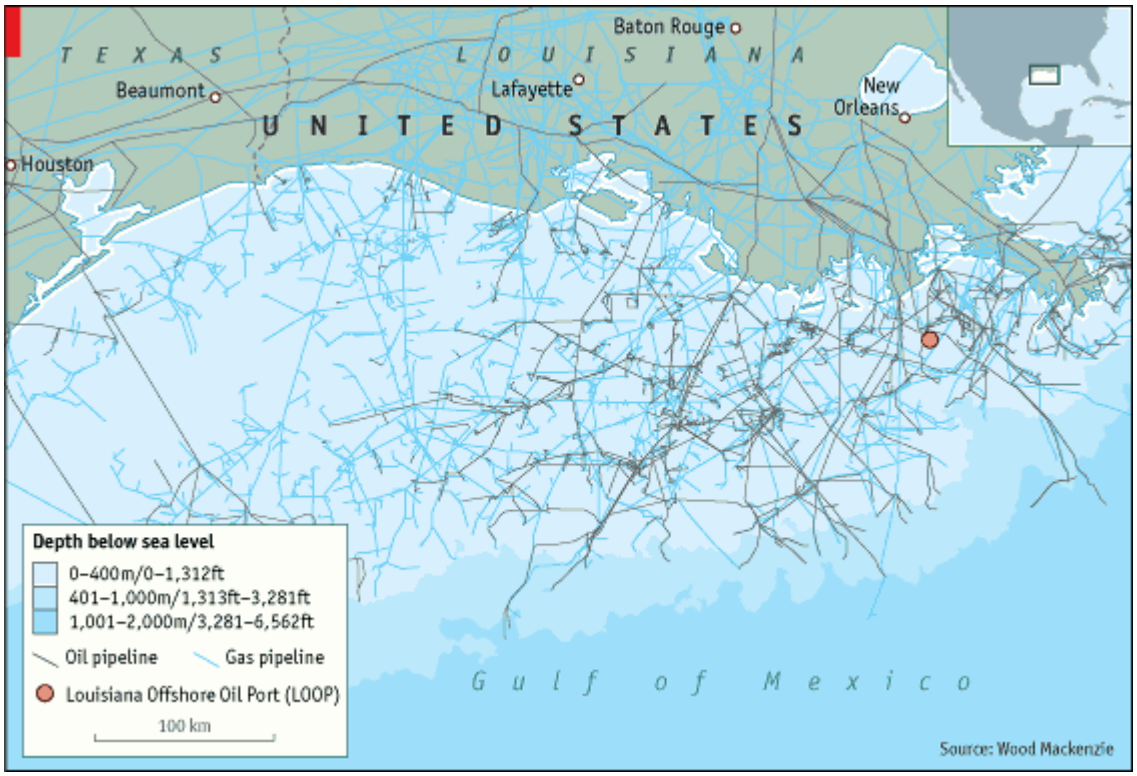
Charley and Ivan, which pounded Florida last year—tend to have a fleeting impact. In the short term, the disruption caused by a big storm can depress output; over the longer term economic growth is boosted by reconstruction. For all their devastating force, natural disasters tend to be economic weaklings.

A changed world

Katrina, however, may cast a longer shadow, thanks both to the storm's geography and its timing. The hurricane pounded an area vital to America's oil-and-gas industry at a time when soaring global demand and low inventory levels had already sent oil and petrol prices to record nominal levels. Economists were fretting about the impact of higher fuel prices on America's consumers long before Katrina struck. Now they are puzzling over two riddles: how big will the energy-supply shock be? And how will consumers react to sudden leaps in energy prices?

The Gulf of Mexico is clearly home to a lot of America's energy infrastructure. About a quarter of the country's oil and gas is produced in rigs there. Over 90% of those rigs were shut down as the storm approached. On August 31st, the Coast Guard said that 20 of the rigs were missing. Several are reported to be drifting in the Gulf.

Less visible to the naked eye, but more important for energy supplies, is a latticework of underwater pipelines that brings these hydrocarbons to shore (see map). In 2004, Hurricane Ivan precipitated underwater mudslides that damaged several of these pipelines, disrupting supplies. At the worst point, one-third of the oil and a fifth of the gas produced in the Gulf was knocked out.



Initial panic sent the price of crude oil soaring to over $70 a barrel on the New York Mercantile Exchange on August 30th. But prices subsequently fell, as the news of production damage seemed

less bad than many feared. Traders were particularly pleased that the Louisiana Offshore Oil Port (LOOP), an oil terminal near New Orleans, seemed undamaged. This port unloads about 1m barrels of foreign oil a day, or more than 7% of America's total imports. It is also the only port in the Gulf of Mexico that can handle the very biggest tankers.

Crude oil prices were also dampened by Mr Bush's decision on August 30th to make oil from America's strategic reserve available, on loan, for refiners stuck with short supplies. Unfortunately, stabilising crude-oil supplies may not do much to minimise Katrina's economic clout. That is because markets are tighter—and the risks of a debilitating supply shock are higher—in refined petroleum products.

Unlike Hurricane Ivan, which bashed the Gulf's underwater pipes but barely affected the region's refining capacity, this week's storm, and the subsequent flooding, has hit refining capacity. Nine refineries in the Gulf region are shut or underwater. A further three or four are running at low levels. Together they make up about 10% of America's total refining capacity. Several pipelines that send fuel up to the north-east and mid-west are out of action.

The timing was poor. Thanks to tight global supplies and the peak summer driving season, America's petrol stocks, at 194m barrels, were close to record lows before Katrina struck. That figure is now falling by more than 1m barrels a day—and that problem could be exacerbated if Americans rush to fill up their cars in anticipation of a shortage. Not surprisingly, petrol-futures prices have skyrocketed even as crude-oil prices have stabilised. On August 30th, petroleum futures rose 40% and they hit a record high the next day.

Higher wholesale prices usually take a couple of weeks to filter through to the pump, but some oil companies are already rationing the petrol they distribute to wholesalers. Dry petrol pumps have been spotted in parts of the country. Prices have reached $4 a gallon in Chicago and nearly $5 in Atlanta. Traders have begun to talk about scarcity and hoarding.

The economic fallout of this supply shock depends both on its severity and how long it lasts. Philip Verleger, an energy economist affiliated to the Institute for International Economics, predicts that petrol and heating-oil prices could soar in coming weeks, and that parts of the country, especially the east coast, where refining shortages are now more acute, could face temporary shortages. Long lines at the pump, which have not been seen in America since the oil crises of the 1970s, could have a bigger effect on consumer confidence than high prices alone. Mr Verleger believes this kind of supply shock could push America's economy into recession.

Most Wall Streeters were more optimistic—at least at first. The consensus immediately after the storm was that there would be a dent in third-quarter output growth that would be recouped in the fourth quarter or early in 2005. But by mid-week economists were busy downgrading their forecasts. On August 31st, Ben Bernanke, chairman of Mr Bush's Council of Economic Advisers, insisted that the hurricane's impact on America's economy would be modest, providing that the energy impact was only temporary.

Reuters

And there is a case for optimism. With Labour Day approaching, America's summer driving season comes to an end. Environmental regulators relaxed pollution standards on petrol this week. Oil companies will do everything they can to get refineries running as soon as possible (though Edward Morse, an analyst at HETCO, an oil-trading firm, thinks that may take four months). And America will doubtless import more refined product to make up for some domestic supply constraints—though that will push up international prices, broadening Katrina's effect.

Even if petrol prices do stay higher for a while, that does not necessarily imply recession. After all, America's consumers have put up with huge rises in fuel prices over the past two years—and not stopped spending, preferring to save ever less instead. Lower interest rates may also help: long-term rates have fallen back towards 4% as bond markets have fretted about a slowing economy. All the same, at some point, something will persuade America's debt-laden consumers to keep their money in their pockets.

Refined danger

Over to you, George

A recession is only one of several ways in which Katrina could hurt Mr Bush. The president, who cut short his fishing-and-biking holiday and rushed back to Washington, DC, generally does well in such crises, but this one looks taxing.

Difficulties in Iraq have dragged down his popularity ratings—and his critics have spotted an Iraq angle to the disaster. The force that usually responds to natural disasters, the National Guard, has been depleted by deployments overseas. Meanwhile, Katrina pinpoints two of Mr Bush's weaker suits—energy and the environment. Just a few weeks ago, the former oilman signed a pork-stuffed energy bill doling out billions to the industry. In a *Washington Post* poll, taken just before Katrina struck, two-thirds of the respondents complained that petrol prices were causing financial hardship to their families.

Before his address to the nation, there had been rumours that Mr Bush would call on Americans to conserve energy. That plea—always risky, because it can cause a run on the pumps—may yet have to be made. But Mr Bush instead took the high road, praising the emergency workers and asking for patience. “Right now the days seem awfully dark for those affected,” but in time “the great city of New Orleans will be back on its feet.”

In that at least he is right. One of the city's greatest allures has always been its sense of danger and the unusual. But it will take a long time before it can live up again to its hedonistic Cajun motto, “Laissez les bons temps rouler.”

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Affirmative action in Hawaii

Sun, surf and secession?

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From The Economist print edition

AP

A daft proposal for racial separatism approaches the Senate

WHEN Queen Liliuokalani of Hawaii was overthrown by a band of local rebels in 1893, not many of her subjects cared. At least, not enough to fire a single shot in her defence. Nonetheless, the incident, which some say occurred with American connivance and which led to the annexation of Hawaii to the United States, is now a source of immense grievance to some native Hawaiians.

Bill Clinton apologised for it in 1993, even though, strictly speaking, it was not his fault. But that was not enough for Daniel Akaka. The Democratic senator has tabled a bill to right the wrongs of the past by granting “self-governance” to native Hawaiians. The Senate is to consider the bill next week.

A casual observer might think that a century under the American yoke has not been all bad for native Hawaiians. Their median household income is $52,000, making them slightly better off than white Americans and much richer than any group of Polynesians outside the United States. And they also live in Hawaii.

Statehood was not imposed on native Hawaiians by force. In 1959, they voted for it by a two-to-one margin. Since then, native and non-native have rubbed along well enough to marry each other with casual abandon. Back in 1984, only 4% of native Hawaiians were classified by the Office of Hawaiian Affairs as pure native Hawaiian, and colour-blind love must have reduced that figure since then.

Mr Akaka's gripe, however, is that native Hawaiians have been denied the degree of self-determination that has made Native American reservations such happy places. His bill, which is supported by Hawaii's Republican governor and its other Democratic senator, would allow the creation of a separate “governing entity” for native Hawaiians. Exactly what this would entail is unclear, but it seems to allow the one-quarter or so of Hawaiians who can show native ancestry to

choose to be governed by a different set of laws from their neighbours.

That could have interesting consequences. Unlike Native American tribes, which have been separate political entities since before the American constitution was framed, native Hawaiians live intermingled with those whose ancestors arrived more recently. So, under the new system, could you have two shops side by side, one of them paying taxes, and one exempt because its owner has a drop of native blood? Asked that question by a caller to a Hawaiian radio station, Robert Klein, a lawyer for the Office of Hawaiian Affairs, which is promoting the Akaka bill, replied: “I don't know. We would need to see how that will play out in the negotiations.”

Would this sort of thing foster harmony between native and non-native Hawaiians, as the bill's sponsors suggest? “The opposite is more likely,” says Rubellite Kawena Kinney Johnson, a local academic and prominent native opponent of the bill. “Different laws for different races” is a system with an inglorious history. It is also unconstitutional, say the bill's critics. And it could pave the way for other ethnic groups to demand new rights based on perceived historical injustices. Latinos could make a case that they would be better off had the United States not beaten Mexico in the war of 1846-48. And don't even get started on blacks.

In an unguarded moment, Mr Akaka admitted that his bill could lead to independence for native Hawaiians. Amid the ensuing uproar, he retreated, while carefully keeping that option open. The threat of secession could help the new racially-exclusive native authority squeeze more concessions out of the federal or state government.

And that still leaves the most amazing thing about the Akaka bill. It might pass.

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Base closures and politics

The meaning of Ellsworth

Sep 1st 2005 | RAPID CITY, SOUTH DAKOTA
From The Economist print edition

The air force has a future in South Dakota. Do the Democrats?

AP

A legacy is saved

IT WOULD take a direct hit from an enemy warhead to breach the 25 tons of steel and 12 inches of concrete that encase the nuclear missile silo on Ellsworth air force base in South Dakota. But the Minuteman missile it so snugly houses is now just for show—the armed missiles were retired between 1991 and 1994. Now a site that once helped deter the Soviet threat attracts tour groups and the occasional rabbit.

The base itself survived a near miss last week. The nine members of the Base Realignment and Closure (BRAC) commission voted on the future of Ellsworth and 32 other big military bases the Department of Defence wants to shut down. The commissioners spared five of these bases, including the Pentagon's most controversial targets: Portsmouth naval shipyard in Maine; the submarine base at New London, Connecticut; and Ellsworth. The president can either accept their recommendations in their entirety or reject them outright. But he cannot re-open any case they have chosen to pass over.

The Pentagon will be disappointed with the commissioners' conclusions. Closing bases was part of its push for “transformation” of America's armed forces. On the front line, “transformation” evokes something zippy, like replacing boots on the ground backed by heavy artillery with fleet-footed commandos and precision air strikes. But back at base it means something rather humdrum, such as minimising the amount of space the department leases from other landowners.

In total, the Pentagon made 222 proposals to close or modify bases, which it estimates would save almost $50 billion over 20 years. But its calculations have been disputed by the Government Accountability Office. Though the Pentagon planned to cut a lot of jobs, accounting for 47% of its projected annual savings, it did not intend to sack many people. Instead it wanted to transfer them from one job to another. This would spare the Pentagon the expense of hiring new people to do those new jobs, but it would not shrink its payroll.

At Ellsworth, the Pentagon wanted to cut about 3,800 jobs. It also wanted to realise economies of scale by putting all its B1 bombers in one place: Ellsworth's 24 “birds” would join the rest of the flock at Dyess air force base in Texas. This “legacy fleet” was inherited from the cold war. The aircraft were scattered around the country to prevent them all being destroyed in a single Soviet attack. Some commissioners wondered whether this cold-war wisdom was being dismissed too lightly. What if the Dyess runway were disabled by terrorism or tornadoes? Or tort lawyers for that matter. Dyess has been embroiled in litigation with local landowners who complain that the aircraft disturb their cattle, putting them off the vital business of breeding.

Ellsworth seems to enjoy better relations with its host region. It is not beset by angry cattle-

ranchers. Nor do local people covet the more than 4,000 acres of land devoted to the base. The average square mile of South Dakota is shared by just ten people; there are plenty of acres to go round.

Far from being seen as an obstacle to property developers, Ellsworth is the biggest employer in South Dakota—besides the state government and Sioux Valley Hospitals. Its annual payroll amounts to over $160m, much of which is spent on businesses outside the base perimeter.

Less than nine miles from Ellsworth, in Rapid City, Donald Rice sells the four-wheeled Honda motorcycles (customers call them “crotch rockets”) that occupy the driveways of some families on base. In years past, he even used to employ some of the younger servicemen at his dealership. “They thought it was fun,” he says. “It was better than cleaning latrines.” He appreciates the servicemen's friendship (many, he says, come back to South Dakota to retire) and their purchasing power. What they spend at local businesses, locals in turn spend at places like his. This is what economists call the “multiplier” effect, and what Mr Rice more vividly describes as “the round-robin effect”. According to the Department of Defence, as many as 2,900 jobs outside the base depend on this round-robin effect.

The base is deeply woven into the state's politics. Tom Daschle, the Democrat who served the state in the Senate for 18 years, cast himself as Ellsworth's protector in Washington. Despite this, he famously lost his seat last November to John Thune, a Republican 13 years younger and a good bit taller. Had Ellsworth closed, as many people expected, the vanishing tribe of Plains Democrats would have claimed that Mr Thune was a walking example of the dangers of replacing a senior figure with a fresh face.

Instead Mr Thune mounted an energetic campaign to defend Ellsworth that some Republicans thought bordered on disloyalty. But the non-closure of the base will help his party. Six in ten South Dakota voters plumped for George Bush last November. The state's other senator, Tim Johnson, a Democrat, held on to his seat in 2002 by only 500 votes. South Dakota has kept its “legacy fleet” of B1 bombers; whether “legacy” Democrats can survive in the Plains is another matter.

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Chicago

Grease for the meat

Sep 1st 2005 | CHICAGO
From The Economist print edition

A hugely successful mayor begins to be bothered by scandal

LAST week Richard M. Daley, one of America's most powerful mayors, was questioned for two hours by federal law-enforcement officials. The *Chicago Sun-Times* had exposed an obscure programme in which the city paid politically connected truck owners to do little or no work, sometimes for bribes.

Once the feds began turning over stones in the “hired truck” scandal, other things started to smell bad, too. Federal prosecutors now allege that many city departments rigged the hiring process to dispense jobs as political favours. So far, 23 people have pleaded guilty; eight more are awaiting trial.

The top FBI official in the city told reporters after the mayor's interview that Mr Daley is not a target “at this time”. Yet Chicagoans with long memories vividly recall another Mayor Daley, Richard J., the mayor's father, who in his time made the city a byword for corruption; and they do not need long memories to recall that George Ryan, the former governor of Illinois, was not a target either when he was first questioned by federal officials in a different corruption scandal. Mr Ryan will soon go on trial on federal racketeering charges.

Mr Daley, a notorious workaholic with simple tastes, is unlikely to have lined his pockets with taxpayers' money. But might he have tolerated, or even encouraged, doling out jobs as political favours to tighten his control over the city?

If so, some Chicagoans are asking a different question *sotto voce*: does it matter? Mr Daley has pulled off ambitious takeovers of the city's schools and its awful public housing. The city has never looked better; the schools will open on time this year, whereas, in decades past, teacher strikes were an autumn ritual. The *Sun-Times*, his tormentor, has just finished a four-part series on the city's revitalised downtown that praised his visionary leadership.

“Government needs a little grease to cook the meat,” says Paul Green, a professor of policy studies at Roosevelt University in Chicago and the author of a book on Chicago's mayors. “You could reform yourself until nothing happens.” But clearly many voters could do with less grease. A *Chicago Tribune* poll, taken amid the scandal but before Mr Daley had his chat with the feds, found that the mayor had an approval rating of 53%—a sharp tumble from the 79% of the vote he won for re-election in 2003.

At a minimum, his opponents smell blood. Congressman Jesse Jackson junior, whose district includes Chicago's far south side, is acting as if he is interested in the mayor's job. Come election time in 2007, after nearly two decades at Chicago's helm, Mr Daley may well decide enough is enough—assuming no one else decides that for him first.

Venezuela

Cowing the private sector

Sep 1st 2005 | CARACAS
From The Economist print edition

The ever-extending tentacles of Hugo Chávez's "21st-century socialism"

Get article background

THE crowded beach of Camurí Chico, squeezed between Venezuela's coastal mountain range and the Caribbean sea, is not the first place one might look for experiments in "21st-century socialism". But if Venezuela's president, Hugo Chávez, has his way (and few are betting against him these days), the country's economy will soon start to look a lot less capitalist and a lot more like this beachfront.

Nearly six years ago, devastating mudslides obliterated much of Vargas state, just north of Caracas, killing thousands of people. In effect, Camurí Chico ceased to exist. Recovery has been agonisingly slow. Somewhat reluctantly, the vendors who used to operate out of ramshackle wooden huts agreed to form a co-operative, demolish their huts and trust the government to replace them with purpose-built modules.

The government kept its word, and the Brillo del Mar co-operative is now in business. "It isn't easy," admits its chairman, Víctor Mendible. "You have to accept what the majority wants. But we're 100% better off now." The 32 co-op members have a 15-year concession allowing them to run everything from the car park to the cafés.

Capitalism, says Mr Chávez, is the root of all evil. Poverty, corruption, the decline in moral values—all are the fault of "savage neo-liberalism" and globalisation. The only hope for the world is a society based on socialist solidarity. Many wonder whether private enterprise—theoretically

guaranteed by the 1999 constitution that Mr Chávez himself fathered before he openly embraced socialism—has any place in this Utopian vision. There is even speculation that the president's "Bolivarian revolution", ever more closely tied to Fidel Castro's Cuba, might take the road towards collectivisation.

Nonsense, the government retorts. There are to be new types of businesses, mixed public and private, dubbed "social production companies" (EPS). But normal capitalist firms will continue to co-exist with them. The EPS segment will be based around co-operatives, such as Brillo del Mar, whose number has already leapt from fewer than 1,000 when Mr Chávez came to power in 1998 to an estimated 67,000 today. But there will also be more companies run under workers' co-management schemes. The "community" is to be involved in decision-making, and part of the production and/or profits will be devoted to projects that benefit it.

Mr Chávez's version of co-management has been greeted coolly by private-business leaders, who say it would prevent them from applying normal market criteria. But many fear that they may have no choice. Firms seeking government assistance of any kind—even those bidding for public contracts—are increasingly being told that only co-operatives or co-managed businesses will be considered. Legislation already in draft envisages a wide range of circumstances under which firms could be obliged to adopt co-management—if they are considered to be "of public utility or social interest", have ever received government aid, or go bankrupt, for example.

According to Conindustria, Venezuela's industrialists' organisation, around 40% of the country's 11,000 industrial concerns have gone bust since Mr Chávez came to power. He recently threatened to expropriate some 700 idle firms, along with more than 1,000 working below capacity, unless their owners resumed full production. One large company, the paper firm Venepal (now Invepal), was confiscated earlier this year and put back into operation with government money under a co-management scheme. Many state-owned enterprises are now attempting to implement different forms of workers' control, with mixed results. Nowhere, though, has the state relinquished its majority stake.

The government now has a virtual stranglehold on the economy, thanks to state ownership of the oil industry, representing more than a quarter of GDP, and to a variety of recent government measures including exchange controls, price limits and credit regulations. It recently launched four agro-industrial businesses supplying staple products such as milk and maize flour, and its retail-food chain, Mercal, aims to cover 60% of the market.

Private farmers feel pressured from all sides—threatened with expropriation, heavily dependent on credit and subject to regulations that, they complain, force them to sell below cost. "I need a loan for a tractor," one farmer explains: "But even if I go to a private bank, they demand a 'productive farm' certificate, which I can only get if the [government] land-reform agency puts me on the agrarian register." The agency twice "lost" the title documents he submitted to support his application—a common experience, he claims, among those who signed a referendum petition against Mr Chávez.

Venezuela's once pugnacious private sector, which has backed several failed attempts to remove the president, now looks cowed. The recently elected head of its main federation, José Luis Betancourt, a prominent rancher, won fame when he publicly tore up the 2001 land-reform law. Now he talks meekly of "co-existence" with the government so long as it respects the law. But with the 51-year-old Mr Chávez on course to win total control of parliament by early next year, and planning to remain in power for another quarter of a century, "the law" is likely to become whatever he wants it to be.

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Argentina's general election

Perennial Peronist power

Sep 1st 2005 | BUENOS AIRES
From The Economist print edition

The opposition once again fails to get its act together

Get article background

AFP

Cristina: the president's greatest asset

LONG simmering, Argentina's fiercest political family feud has burst into the open with the official opening of campaigning for next month's legislative elections. Although neither Néstor Kirchner, the current president, nor his predecessor, Eduardo Duhalde, is running for office, their rivalry has grown more bitter than ever as their wives compete for a federal Senate seat in the province of Buenos Aires. Launching her candidacy, Mr Kirchner's spouse, Cristina Fernández, lambasted Mr Duhalde as a Mafia don, while her opponent, Hilda González, recently denounced the first lady's supporters as “traitors”.

Such theatre is hardly unusual in Latin American elections. But what makes the Kirchner-Duhalde family feud unique to Argentina is that it is being fought within the same political party. The Peronists have dominated Argentina for half a century, but rarely has their hegemony been more complete than now—despite their internecine duelling. This is largely because the Radicals, who form the main opposition party, have been in tatters ever since Fernando de la Rúa, Argentina's last Radical president, resigned during the 2001 economic crisis.

In the 2003 presidential election, three Peronist candidates ran against one another, giving the opposition a perfect opportunity to exploit their divisions. But they failed to unite and Mr Duhalde mobilised his Peronist party machine to propel Mr Kirchner, his chosen successor, into the Casa Rosada. Now that Mr Kirchner has turned against his former patron, the opposition has a new chance to take advantage of the Peronists' feuding, but it seems even less capable of coming together.

Indeed, in the Buenos Aires Senate race, the split Peronist ticket could even hurt it. In a bid to ensure minority representation in the Senate, the constitution grants two seats to the winning party and one to the runner-up in each province. However, since Mrs Kirchner, who is widely expected to win, is running on a “Front for Victory” ticket, the minority slot is likely to go to Mrs Duhalde's Peronists, shutting out the non-Peronists entirely in the most important constituency.

With enough time, the Radicals may be able to reinvent themselves by emphasising two of their traditional strengths—healthy public institutions and a separation of powers, both particularly salient issues given Mr Kirchner's overbearing style in government. But such hopes suffered a major setback in July in the Radicals' internal election for leader in the province of Buenos Aires.

For the next presidential election due in 2007, many liberals had pinned their hopes on Margarita Stolbizer, a Radical congresswoman who says she supports a market-friendly approach to improving income distribution while keeping the party's focus on good government. But she was defeated by Raúl Alfonsín, a former Radical president also tainted by an economic crisis—the hyperinflation of 1989. Although Mr Alfonsín, now 78, is not popular nationwide, his influence over mayors and party functionaries in the greater Buenos Aires region proved too much for the reformist Ms Stolbizer to overcome.

With the economy continuing to rip ahead, Mr Kirchner appears a political juggernaut. But unlike Mr Duhalde, who commands a vast network of support from local officials, Mr Kirchner's strength stems almost exclusively from steering ample federal largesse to politicians with contested loyalties. “Duhalde is a godfather,” says Luis Tonelli, a columnist for the magazine *Debate*, “but Kirchner can only be a contractor.” As soon as the economic pace slows—and, given worryingly low investment levels, some deceleration is likely before 2007—the president may find himself vulnerable, with neither sufficient cash nor the Peronist apparatus to grease the electoral wheels in his favour.

Without the cushion of a growing economy, Mr Kirchner's autocratic tendencies would become a greater political liability. But the opposition would have to convince voters that they are ready for power again. “Institutional quality is important but insufficient,” says Ms Stolbizer. “The only message people will hear is what will improve their own lives. We need to propose an alternative that can govern.” That could be a long time coming.

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Economist.com WORLD LATIN AMERICA

Haiti

The death squads return

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An atrocity, with police collusion

Get article background

IN THE run-up to November's general election, Haiti is being hit by a new wave of vigilante violence, often backed by rogue police units. In the latest incident, at least eight people—and perhaps as many as 20—were hacked to death with machetes in a “Play for Peace” football tournament in the hillside slum of Martissant. The event, sponsored by the US Agency for International Development, was supposed to help youths in poor communities find alternatives to gang violence.

The motive for the attack is still unclear. Dozens of people have been hacked to death over the past few months in vigilante justice that often accompanies police operations in slums regarded as strongholds of support for the ousted president, Jean-Bertrand Aristide. The authorities blame his followers for the violence that has killed at least 700 people in the past year. Others put it down to gang rivalry. The two are not mutually exclusive.

Some witnesses to the Martissant massacre on August 20th claimed that the hooded attackers were members of a nearby gang seeking revenge in a turf dispute. What is not contested is that they showed up at the tournament with black-uniformed riot police who surrounded the area and ordered everyone to lie down. According to Roland Roy, a local community leader, the machete-wielding vigilantes then moved in, singling out alleged “bandits” and hacking them to pieces while the police looked on.

The American-funded sports event was perhaps an inviting target for extremists who accuse the Bush administration of secretly conspiring to remove Mr Aristide, who was toppled from power in an armed revolt in February 2004. Following a spate of gang violence in Martissant last year, local community workers had sought to clean up the area, hitherto with notable success. Indeed, Martissant had come to be regarded as something of a model.

Haiti has a long tradition of paramilitary death squads dating back to the *Tonton Macoutes* of François “Papa Doc” Duvalier, the former dictator. Mr Aristide also became notorious for using slum gangs, the so-called *chimères*, to do his dirty work. The emergence of a new species of armed civilians, known as *attachés*, working in cahoots with police units, is alarming. Not all the police are bad, of course. But as members of an undermanned, undergunned force, who are subjected to constant threats and blackmail, many inevitably fall by the wayside.

United Nations officials say they are investigating the Martissant killings. But many wonder what good that will do. Previous UN investigations into other atrocities involving the police have so far yielded no tangible results. The credibility of the UN's “stabilisation” mission in Haiti has been further undermined by its failure to take firmer action in imposing law and order. Recent bloody raids by UN forces against pro-Aristide gangs in Cité Soleil, Haiti's largest slum, only brought the mission further criticism for causing unnecessary civilian deaths.

The UN mission is now under pressure to take back territorial control from the gangs before the November elections. With just two weeks left before the electoral lists close, about half of Haiti's 4m eligible voters have registered. While this is a fairly low proportion, diplomats feel that it should be sufficient for the new government to claim legitimacy. That is all the more reason for Aristide loyalists to step up the violence. A smooth election would make a comeback by the former president, now living in exile in South Africa, even less likely.

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Drugs in Colombia

Hand picked

Sep 1st 2005 | BOGOTÁ
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New twists in the war on coca

Get article background

Reuters

No, not camouflage: coca

SINCE it began receiving large-scale American aid in 2000, Colombia's government has based its push against the country's illegal cocaine industry on a massive campaign of aerial spraying of the coca crop with glyphosate, a weedkiller. The hope was that successive dousings by American-supplied crop-dusting planes would wipe out coca, thus also cutting the drug income of the FARC guerrillas and their right-wing paramilitary opponents of the United Self-Defence Forces of Colombia (AUC).

At first the government claimed success. According to surveys by the UN Office on Drugs and Crime, land under coca in Colombia shrank to 86,000 hectares (212,500 acres) in 2003 from a peak of 163,300 hectares in 2000. But since then, spraying seems to have brought diminishing returns. According to the latest UN survey, land under coca fell only 7% in 2004, to 80,000 hectares even though 136,000 hectares were sprayed. So Álvaro Uribe, Colombia's president, has changed tactics.

The most important of these is to pull more coca bushes up by hand. The government has long tried this in national parks, where spraying is banned. Now it is expanding this effort. In the first seven months of this year, it uprooted 13,384 hectares of coca and hopes for a record 30,000 hectares by the end of the year. Manual eradication, says Luis Alfonso Hoyos, a presidential adviser, is cheaper (at $350 per hectare) than spraying. It is more effective, too, as coca requires repeat applications of glyphosate before it dies. He also hopes it might attract aid from EU countries, who dislike aerial spraying.

Although this approach has been tried before, it has never been applied on such a large scale. Why? Because the FARC or AUC, not the government, controlled the areas where coca is grown. Officials claim that Mr Uribe's “democratic security” strategy now makes manual eradication possible. Even so, security remains a problem. Not surprisingly, coca farmers rarely welcome eradication teams. These are made up of peasant farmers as well as FARC and AUC deserters. They live in camps protected by police and troops. Some have faced intimidation. In Tumaco, the FARC attacked an eradication camp, wounding six workers and six police.

Yet the biggest weakness of Mr Uribe's forcible eradication programme is that it does not offer durable alternatives to coca. A big alternative-development scheme, financed by American and European aid, has had modest success in Bolivia. But even there, land under coca is creeping up again, having almost doubled since its low point in 2000, according to the UN.

Such programmes are more likely to be sustainable if they proceed through negotiation with the farmers, according to Francisco Thoumi, an economist at Rosario University in Bogotá. But he notes that farmers' organisations are weaker in Colombia than Bolivia. Only in Putumayo, on the border with Ecuador, and in some highland areas where opium poppies are grown, has the government tried voluntary eradication in exchange for help in growing and marketing legal crops. This has been moderately successful, on a small-scale: under these schemes, 23,000 hectares of coca and poppy have been pulled up since 2001, and replaced by licit crops covering an area three times as large.

Officials say that aerial spraying will remain the mainstay of their anti-drug effort. But critics point out that while demand for cocaine remains unchanged, spraying merely drives coca cultivation deeper under the jungle canopy, where it is harder to detect, as well as stimulating the development of higher-yielding and herbicide-resistant varieties. Mr Uribe recently suggested that his government buy the coca crop from the farmers. That smacks of desperation. He is not the first Latin American president to find himself squeezed uncomfortably between American pressure to win “the war on drugs” and the market realities that make victory so hard.

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Japan's election

The woodpecker and the lumberjack

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AP

Junichiro Koizumi makes the running, but voters may benefit no matter who wins

Get article background

THE big event is still a week away, but Junichiro Koizumi is looking cleverer by the day. Less than a month ago, Japan's prime minister divided his fusty old party and called a risky snap election, in a bid to win public backing for his plan to privatise Japan's massive postal-savings scheme. At the time, this looked dangerous. By chasing out the 37 members of his Liberal Democratic Party (LDP) who had voted against his plan in parliament's lower house, Mr Koizumi has forced his ruling coalition to defend a razor-thin margin in the election due on September 11th, against an opposition party—the Democratic Party of Japan (DPJ)—that has made huge inroads in recent years.

Mr Koizumi has run a shrewd campaign, however, and surged ahead in opinion polls. He stole the limelight from the DPJ by recruiting a team of high-profile candidates, many of them new to politics (and dubbed “assassins” by Japan's media), to take on the LDP rebels in their home districts. Most voters agree that his signature issue—the privatisation of Japan Post, and its ¥330 trillion ($3 trillion) of savings and life-insurance assets—is the most important of the campaign.

The opinion surveys are sketchy, and the LDP split has muddled the arithmetic in many constituencies, so Mr Koizumi's wide lead may turn out to be illusory. This being Japan, however, many reformists are now worried for a different reason. They fear a comfortable victory for Mr Koizumi and the LDP, which, they say, will lead to gradual privatisation of the postal-savings scheme, but few other reforms of substance. Despite its name, after all, the LDP is notorious for

being neither liberal nor democratic; and the DPJ is meanwhile promising an impressively wide-ranging panoply of reforms.

One reform or many?

The DPJ, led by Katsuya Okada, has clearly been frustrated by Mr Koizumi's skill at portraying Japan Post as a litmus test for reformists. Mr Okada argues that, unlike the LDP—which he says is incapable of reforming itself after half a century of nearly continuous rule—the DPJ will pursue sweeping changes for the good of ordinary people. While Mr Koizumi is perched on high, hammering away at one issue like a woodpecker and dazzling the media with his plumage, the DPJ is waving a giant axe at the base of the tree, frantically trying to attract voters' attention.

Whereas Mr Koizumi's party could not even agree on a pledge to cut the civil-service payroll by 10%, for example, the DPJ is promoting a plan to slash it by 20%. Whereas the prime minister is vague about other planned spending cuts, the DPJ vows that it will outdo him with cuts of ¥10 trillion over the next three years. And although Mr Koizumi is correct to pay some attention to postal savings, says the DPJ, its own postal plan would shrink the state's influence even more than his, by halving the assets of Japan Post before eventually selling it. None of these campaign promises seems any match for Mr Koizumi and his all-star team of assassins.

Still, after the battle that Mr Koizumi has waged within the LDP, a vote for the party hardly looks like a vote for the status quo. To see why, it helps to distinguish between two sorts of change. The first—rapid liberalisation towards something close to a free-market domestic economy—has always seemed implausible. It is hard to imagine any political alignment that could risk moving too fast for Japan's voters, who dread the unpredictable.

Other long-overdue changes, however, do have majority support, and many young and urban voters are desperate for them. These do not add up to an ideological revolution so much as a big shift in power away from narrow, outdated interest-groups and towards the interests of the majority of Japanese. Instead of allowing central bureaucrats, construction lobbies, doctors and postmasters to hold government policy hostage, most voters would prefer the government to pay attention to the core issues—pensions, health care, schools, police and so on—that they have been worrying about, and which politicians in other democracies do at least pretend to address.

It is this appetite that the DPJ is trying to satisfy in its speeches and its manifesto. The opposition's goal is not so much to shrink the state as to rescue it from outworn special interests. The party wants to take power away from the central bureaucracy, for example, and increase the power of local governments. It wants to cut spending on public works, but raise consumption taxes to fund better pensions. It is keen on small-business subsidies, but wants to dole them out with fewer hassles. And although the DPJ is pledging to reduce deficits overall, to ¥30 trillion a year, that is the same target that Mr Koizumi promised when he took office four years ago.

As popular as these changes are, its inexperience, a rural voting bias and the LDP's power of incumbency have made it hard for the DPJ to win office. But now, by shaking up his own party, Mr Koizumi has given the LDP a similar chance to become more responsive to modern voters. If this election founds a system of vibrant two-party competition, Japan will have undergone a monumental change, no matter who wins.

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Indonesia

Rupiah ructions

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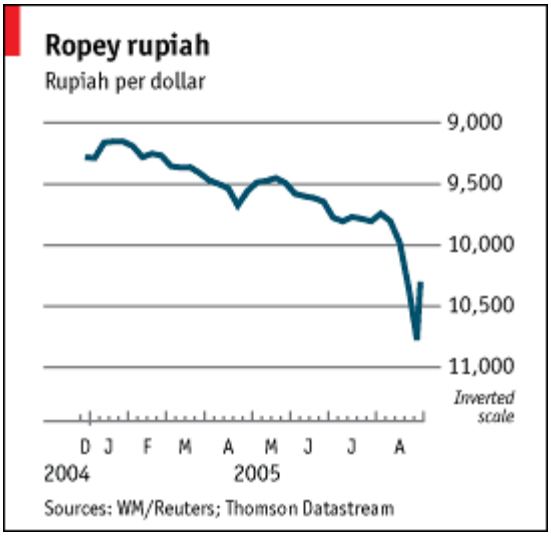
The rupiah is plummeting; bad government is to blame



Get article background

THIS was supposed to be the year the Indonesian economy came into its own. The popular new president, Susilo Bambang Yudhoyono, had initiated an investment drive and cracked down on corruption. Foreign investors were taking an interest, for the first time since the Asian crisis of 1997-98. Yet in late August the rupiah plunged to its lowest level in four years, pulling shares down with it. On August 29th alone, Jakarta's main index fell by over 5%. The currency and stockmarket regained a little ground only after the central bank announced an interest-rate rise of 0.75 percentage points the following day. What has gone wrong?

The short answer is fuel subsidies. For a long time, the government has fixed the price of petrol and other fuels well below the international rate, and paid for the difference itself. As the price of oil has risen, so has the government's bill. But the authorities are reluctant to raise prices, for fear of public protests. After all, angry demonstrations against higher fuel prices helped to topple Suharto, Indonesia's strongman of 30 years, in 1998. Mr Yudhoyono did risk raising prices by 29% in March, while promising not to raise them again this year. But the international oil price has risen faster still, causing the cost of the subsidy to balloon. The government might end up spending as much as $13 billion on it this year—over six times what it originally budgeted. As Indonesia's bill for oil imports has risen, the current-account surplus has shrunk, and the rupiah has gradually depreciated (see chart).

But this explanation is misleading, because Indonesia also exports some oil and lots of gas. Although the subsidy is expensive and inefficient, the government's revenues from exports cover

most of the cost. Economists reckon that for every $10 the oil price goes up, the government deficit rises by only about 0.2% of gross domestic product, and the balance of payments declines only marginally—hardly the stuff that economic crises are made of.

Instead, it is the authorities' limp and tardy response to a number of worrying trends that seems to have spooked the markets. As Michael Chambers of CLSA, an investment bank, points out, domestic oil production is declining, while consumption is increasing, so that the subsidy bill, even if manageable in the short term, will soon spiral out of control. The government says it wants to encourage investment in the oil sector to increase local output, yet has spent the past year bickering with Exxon Mobil over the extension of a production-sharing contract.

Meanwhile, the central bank, which had spurred the rupiah's decline by allowing the spread between local and foreign interest rates to narrow, only began raising rates at the beginning of August, and even then just by 0.25 percentage points. At the same time, it revealed that it had squandered one-tenth of its reserves in a vain attempt to stem the rupiah's fall. Despite a few high-profile foreign investments, the capital account remains lamentably in the red. A much hoped-for privatisation programme seems to have stalled.

The government's public relations have also been lousy. Officials often contradict one another, fail to explain themselves, or project an air of confusion. Jusuf Kalla, the vice-president, was pushing for lower interest rates even as the central bank was preparing to raise them. The chief economics minister, Aburizal Bakrie, said the rupiah's decline was not a big concern, just as currency traders were really getting riled. Commentators have begun to call for a cabinet reshuffle.

Yet Mr Yudhoyono himself is one of the chief offenders. He twice delayed the announcement of a package of measures designed to improve confidence in the rupiah. When it finally came, on August 31st, it proved a damp squib. He did promise to raise fuel prices before the end of the year, but did not say exactly when or by how much. In fact, he stressed that subsidies would not be abolished, but only reduced. He also pledged to reshuffle the cabinet, although not until October, and with no clear aim in mind.

Investors showed unhappiness with those measures by sending the rupiah on a downward course again. But even beforehand, rising inflation and slowing growth had reduced Indonesia's allure. Bankers say interest rates will probably have to rise further to keep the rupiah stable. But officials at the central bank say the government must also pull its weight, preferably before October.

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Economist.com WORLD ASIA

China

A woman's right to sue

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At least on paper

MAO ZEDONG told China's women that they “hold up half the sky”, but they have had little to show for their feat. Women today make up more than 60% of China's vast agricultural workforce, yet occupy barely 20% of the seats in the national parliament. Nor have most Chinese women ever enjoyed the other equalities and protections that the ruling Communist Party's propagandists have long claimed they do. Slowly, that is changing. On August 28th, a committee of China's male-dominated parliament amended the Law on the Protection of the Rights and Interests of Women, for the first time making the sexual harassment of women unlawful, and stipulating that equality between men and women “is a basic state policy.”

Will the new measures change much? In hopelessly vague language, the amended law requires all manner of government bodies, institutions and enterprises to have an “appropriate” (but unspecified) number of women in leadership positions. Key terms, including “sexual harassment” itself, are left undefined. Courts and lawyers must guess just what boorish words or deeds might constitute an offence, and what penalties await the guilty. Yet women now have the right to complain about harassment to their employers and to the “relevant department” in the government, and to bring civil suits against their tormentors (though the law says nothing about how any damages might be calculated).

Such vagueness leaves the law open to the easy criticism that it is a piece of toothless symbolism. Yet Chinese legal scholars note that harassment is now deemed a legal matter, not just one of bad manners and morals, as has been the Chinese tradition. Public discussion and media coverage of the issues, many argue, helped to bring the problem of sexual harassment out from the shadows. It is hoped this will encourage more women to speak out, instead of tolerating abuse because of shame or embarrassment.

The new provisions take effect in December, and China's courts can expect increasing caseloads. In one recent opinion poll, 40% of women in private and foreign-owned businesses claimed to have suffered sexual harassment. Another found that 70% of women working in service industries had similar experiences. A nationwide survey showed that not only had 79% of women respondents suffered harassment, but so too had 22% of the men. The new law bans sexual harassment against women only. Expect China's men to demand equality before this law.

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Pakistan

Pretend democracy

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Rigged local elections peg back the mullahs' power, and pump up the president

Reuters

Hands up who's been to university

Get article background

AS A dress rehearsal for crucial elections due in 2007, supposedly to return Pakistan to true democracy, this month's local elections were discouraging. At least 50 people have been killed in politically inspired clashes. The last, and most important, phase of the vote—to elect 110 district mayors—has been postponed until October 6th, because the electoral commission has ordered re-polling in scores of areas. A turnout of 48% by 30m registered voters was surprisingly high (it was 40% in the previous local and general elections), although, as usual, charges of rigging have discredited the figure.

Yet the government of President Pervez Musharraf is pleased with the results. Although the polls were “non-party based”—a favourite device of military rulers threatened by democratic opponents—officially sponsored candidates and self-declared allies of the government gained more ground than in the last elections, in 2001, especially in the most populous provinces of Punjab and Sindh. More significantly, the religious parties in the unruly border areas of Balochistan and North West Frontier Province (NWFP), which had backed Mr Musharraf before falling out with the general-president earlier this year, lost ground.

Compounding their fall from grace, the mullahs were further dismayed by a ruling of the supreme court on August 25th that should disqualify many of them from holding public office. The court found that certificates from *madrassas,* or religious schools, do not fulfil the educational criteria for contesting local elections. Turning the screw, the court vowed “at an appropriate time” to start hearing a petition filed in 2003 questioning the validity of the *madrassa* degrees held by nearly 68 mullahs elected to the national parliament in 2003. Their election allowed the Muttahida Majlis-i-Amal, an alliance of six religious parties, to form an Islamic government in NWFP and a coalition

government in Balochistan—the most power held by Islamists in Pakistan's history.

And yet the two mainstream opposition parties, loyal to two exiled former prime ministers, Benazir Bhutto and Nawaz Sharif, lost even more ground than the clerics. Mr Musharraf had already drawn much support from Mr Sharif's Muslim League party, while making significant dents in Ms Bhutto's Pakistan People's Party through bribery and coercion. By embedding his supporters in their traditional heartlands, he has weakened them further. And by various means: according to Pakistan's human-rights commission, the polls were roundly rigged and election rules blithely flouted by the government. Mr Musharraf and his ruling party's officials openly canvassed for their preferred candidates; “suitable results” were obtained in Sindh following the gerrymandering of 16 districts; opposition candidates were arm-twisted to cross the floor; officials and senior policemen were transferred to deliver positive results for the government; polling stations were relocated; electoral lists revised. And so on. The opposition has not even been allowed to vent its outrage in parliament, and is now threatening to boycott the next round of voting in October.

Most analysts reckon this has made Mr Musharraf's prospects for ruling after 2007 decidedly rosy. Certainly, officials from the prime minister down to local ruling-party stalwarts are crowing about how the polls have delivered a vote of confidence in Mr Musharraf. The declining fortunes of the religious parties have also gladdened foreign onlookers. But even if these elections have made Mr Musharraf personally more secure for the present, it remains to be seen whether they have made the country more stable, or for how long. The consolidation of one-party rule behind a general is not the democracy that many Pakistanis still crave.

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Nepal

Crowning folly

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From The Economist print edition

The king's autocratic methods worsen Nepal's crisis

SEVEN months after he seized power in Nepal, even King Gyanendra's keenest supporters are aghast at what he is up to. At a Katmandu bar last week, a group of middle-ranking army officers, some with close royal connections, aired their opinions of the government; they were not complimentary. Recently returned from long tours in central Nepal, which is ablaze with a Maoist insurgency, the men had a right to feel aggrieved. Since Gyanendra launched his coup, promising to defeat the rebels, security has deteriorated. Some 60 soldiers are still in Maoist hands after a crushing defeat for the government near the village of Pakha in early August during which 55 of their comrades were allegedly tortured and killed. As an indication of their growing confidence, the rebels last week invited the families of their captives to visit them in prison.

But the king has still found time to crush his democratic opponents. Thuggish policemen routinely break up peaceful pro-democracy demonstrations. This week, the country's ousted prime minister, Sher Bahadur Deuba, appealed to the Supreme Court against his imprisonment on corruption charges by an extra-judicial tribunal, the Royal Commission on Corruption Control. But the emboldened commission is meanwhile looking for new targets: it has charged a leading member of the United Marxist Leninist Party (UML), the second largest political party, with similar crimes. If Gyanendra hoped that such tactics would help him crush the insurgency, he was mistaken. In protest at his assault on political freedoms, the United States and India, Nepal's principal sources of weaponry, have halted arms shipments, leaving the army with a fast-dwindling supply of ammunition. Foreign aid, from Britain and other countries, has meanwhile been reduced.

The king's swelling ranks of critics have tended to focus on the poor quality of his advisers—characterised by the American ambassador, James Moriarty, as so many “convicts” and “bank-loan defaulters”. Perhaps Mr Moriarty had in mind Jagat Gauchan, the minister for physical planning and works, who once served a year in prison in connection with the attempted murder of a journalist. Or the first minister, Tulsi Giri, who has been “blacklisted” by Nepal Bank because of his unpaid debts. The Maoists share the ambassador's poor opinion of the king's advisers. Last week, they bombed a house in Katmandu belonging to Satchit Shumsher Rana, one of a clutch of aristocratic retired generals who surround Gyanendra.

The attack was in line with a general rise in violence in the capital and other towns, reversing a trend that won the king some popular support at first in the weeks after he seized power. In the past fortnight, Katmandu has seen almost daily anti-government riots by students, burning tyres and lobbing bricks in protest at rising petrol prices. The police have responded with tear gas and, in provincial towns, by firing live rounds.

More sensibly, Nepal's political parties have been holding talks on how to end the crisis. Two of them, Congress and the UML, the main parties in the parliament dissolved by Gyanendra, favour opening negotiations with the Maoists. The insurgent leaders have responded warmly.

In a rare interview with state television this week, Gyanendra suggested that he might be willing

to open talks with the parties, if they would only drop the idea of negotiating with rebels. But he continued to insinuate that their current leaders would first have to be replaced, since he accuses the lot of them of corruption. However, the king may have waited too long to offer this modest accommodation. Even as his interview was being aired, the central committee of the Congress party, Nepal's largest, voted to drop its decades-old commitment to constitutional monarchy.

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India

The wild pharmacopoeia

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Can tigers and people co-exist?

Reuters

Wanted: 50 delicious cows

AMONG the collateral damage in East Asia's economic rise have been thousands of tigers. New wealth has boosted demand for costly traditional Chinese medicines. And the tiger is a living pharmacopoeia: nearly every part of it has commercial value. So, across Asia, poaching and smuggling have threatened the species' existence. In India, alarmed by evidence that even fewer tigers survive in the wild than had been thought, the prime minister, Manmohan Singh, appointed a task-force in March to consider what to do. Its members published their report last month. Unhappily for the tiger, they disagreed on one of the most important issues: what to do about the people who share its habitat.

Still, four of the five members, including its chairman, Sunita Narain, a well-known environmentalist, call for a radical new approach to tiger conservation. The present strategy is plainly not working. It called for the relocation of 66,500 families living in 1,500 villages in India's 28 tiger reserves. But since it was adopted, 30 years ago, only 80 villages and 2,900 families have been moved. Those left behind have learned to see conservationists and the tiger as their enemies. Most are tribal peoples and are among India's poorest, lacking any legal status or right to their land. The ruling Congress party, perhaps seeing them as useful potential supporters, has promised a “forest rights law”, to save them from legal limbo. This has been stalled, partly because of the tiger controversy.

Ms Narain does not call for a halt to all relocation, but does argue for a plan for co-existence, by giving people an economic stake in the tiger's survival. The report argues that only by saving the forest—which means helping the people who live there—can the tiger be saved.

Many conservationists are appalled, and the dissenting opinion of one of them, Valmik Thapar, is part of the report. He says that co-existence is “an impractical dream”, because each tiger must eat 50 cow-sized animals a year to survive, and if you put it amid cows and people, the conflict will be “eternal and perennial”. Raghunand Chundawat, another tiger conservationist, who was not on the task-force, agrees, but says it is wrong to see this as a battle between tigers and people. The worry is that the majority report will provide cover for continued government inactivity. Both big cat and poor human stand to lose.

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Iraq

A nearly final constitution

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From The Economist print edition

It is still unclear whether the document agreed upon this week will be endorsed. And if it is, will it help snuff out Iraq's insurgency?

Get article background

IT WAS an exceptionally messy procedure, with corners cut, rules broken and little openness or public debate. For instance, after the constitutional drafters missed their deadline on August 15th, parliament should have been dissolved and a general election called. After a week-long extension, they had still not signed off on a document. Then, days later, under fierce American prodding, a slightly different document was read out to parliament. It was never debated there nor voted upon.

Now, say the drafters, it can still be amended (and presumably endorsed by parliament) before it is put to the people in a referendum. If they say no, there will be a general election and the whole constitution-writing business must begin all over again. It is likely, but not certain, that in at least three of the four (or possibly five) of Iraq's 18 provinces where Sunni Arabs predominate, voters will reject the document by at least a two-thirds majority, in which case it cannot then come into force.

So, given the tortuous, rushed and murky circumstances of its birth, is it a valid or plausible text that can provide a basis for Iraq's hoped-for new democracy—in the event that enough Sunnis are somehow persuaded to endorse it?

Quite possibly, yes. Its biggest merit is that it reflects a consensus of the country's main Shia Arab

and Kurdish leaders, who speak for 80% of Iraqis and once seemed at loggerheads. Indeed, despite the presence of some 15 Sunni Arabs on the drafting committee, it was in essence a Shia-Kurdish production.

Yet their main parties' rank and file had little say in the document as it evolved. Nor did Iraq's many smaller parties. And the firebrand cleric, Muqtada al-Sadr, who has a large constituency of radical Shias, has also declared himself against the draft, though he may yet relent, as he has done on other issues before. Unsurprisingly, most Sunni Arabs, even those few prominent ones who attended the signing ceremony, have rejected the final version.

Actually, much of it is fairly typical of constitutions in the region, albeit that most of them are honoured in the breach. The preamble has a grandiose beginning: “We, the sons of Mesopotamia, land of the prophets, resting place of the holy imams, the leaders of civilisation and creators of the alphabet, cradle of arithmetic...” It commemorates the sufferings of all the country's main ethnic groups under Saddam Hussein, including, pointedly, his fellow Sunni Arabs.

Although the language on Islam aroused much argument, especially among secular-minded Kurds fearful of a Shia theocracy, the final wording—that “Islam is a basic source of law” and that no law should contradict its “principles of jurisprudence”—is fairly uncontroversial.

The document naturally says all the right things about human rights and basic freedoms. It provides for judicial review by a supreme court, where legal experts and religious scholars may both sit, thereby giving the document a stronger religious tint than Iraq's more secular-minded citizens would like. It has an extensive bill of rights, as do the constitutions of the region's more Islamist and most repressive countries. Women must have at least a quarter of parliament's seats.

But the wording is a bit vague about several of the more divisive issues. Oil revenues must be shared out among Iraq's provinces and regions in proportion to their population, but “for a limited period” an extra amount will be set aside for provinces particularly neglected by the old regime, meaning the Shia south. The “Saddamist Baath party” is formally banned, but the wording may leave room for Baathists who disown their former dictator to reinvent themselves. In another crafty formulation, Iraq is declared to be “part of the Islamic world and its Arab people are part of the Arab nation”—which plainly excludes the Kurds in the hope that Arab nationalists will be satisfied.

The document's federalism is its most controversial (and distinctive) aspect. It allows for several provinces to form a “federal region” modelled on the Kurds' present self-ruling zone, including a right to a “regional guard”. Shia politicians in several poor southern provinces say they will try to create a region if given a chance.

Most Sunni Arabs sound willing to accept federalism as an unfortunate fait accompli in the Kurdish north but loathe the idea of it as a national principle, particularly if the Shias form a “super-region” encompassing several provinces or more in the south, with the prospect of a foothold—as they see it—for Iran. Many Sunnis now especially dislike the Supreme Council for Islamic Revolution in Iraq (SCIRI), the country's most powerful Shia Islamist party and the one closest to the ruling mullahs in Tehran. Though its main leaders never promoted federalism before, they are now most ardently demanding a federal zone in the south, around Basra.

Some Sunni Arabs hope to make common cause with Mr Sadr's Shias, who represent their co-religionists' more Arabist wing. Moreover, the Sadrists detest SCIRI, and were fighting against its militias in the holy city of Najaf only a few days before the constitutional draft was finally signed. But the Sadrists may find it hard to sustain an alliance with Sunni ex-Baathists, who once persecuted them. In any case, some Sunni demands—such as for an unqualified affirmation of Iraq's Arab identity—would never be accepted by the Kurds. Other Sunni demands, for instance

for former Baath party members' rehabilitation, would be hotly opposed by their would-be Shia allies.

The Sunnis may be taking a longer view, hoping that once this draft is rejected in a referendum, a very different parliament will emerge after the required general election, giving a much stronger voice to Sunni Arabs. They also hope that in a fresh election SCIRI would do much worse than before, thanks to its perceived unpopularity, even among fellow Shias. The Sunnis then hope that a new document would—among other things—soften the present version's federal character.

That is probably a vain hope. The Kurds and Shias are wedded to their basic bargain: wide autonomy in the Kurdish north in return for the Shias' ability to carve out a more stridently Islamist administration in the south. Even if they have to start writing a constitution anew, that bargain is likely to hold—unless, of course, the country collapses in sectarian civil war. In that case, all constitutions become irrelevant.

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Iraq

Horror at the bridge

Sep 1st 2005 | BAGHDAD
From The Economist print edition

The latest tragedy might, just might, bring Iraqis together

AFP

All that was left behind

EVEN by Iraq's recent dreadful standards, the stampede on Baghdad's Bridge of the Imams on August 31st was an exceptional disaster, leaving more people dead in a single incident than at any time since the Americans invaded two-and-a-half years ago. At least 700 people, many of them women and children, were crushed to death or pushed into the Tigris river where hundreds of them drowned. The toll, say some, could rise to a thousand.

The victims were almost all Shias who, in an annual procession, were commemorating the death of a holy man, Imam al-Kadhem, who died in 799AD and is buried in a mosque near the bridge. The vast gathering was restless after some mortar rounds, presumably fired by Sunni insurgents, had landed by the saint's shrine. A rumour then spread that a suicide-bomber was about to blow himself up in the crowd. It would not have been the first such attack. A suicide-bomber killed scores at the imam's shrine in March last year.

It is mercifully surprising, given the rising sectarian tension, that such tragedies rarely trigger immediate retaliation. Senior Shia clergymen, such as Grand Ayatollah Ali al-Sistani, invariably call for calm. But this horror comes at a particularly bad moment, just as Iraqis limber up for a referendum next month on a controversial constitution which to some extent pits Shias against Sunnis. It may strengthen the hand of those Shias who argue for a separate federal region in the south, safe from Sunni insurgents. It may also bolster the Supreme Council for Islamic Revolution in Iraq (SCIRI), a Shia party whose militia has been taking the law into its own hands against suspected Sunni insurgents. Initial reports suggest that security at the bridge was in the hands of the Mahdi Army, loyal to a radical Shia cleric, Muqtada al-Sadr.

Yet such tragedies sometimes provide a chance for sectarian reconciliation. This time, even some Sunni organisations sympathetic to the insurgents have rushed to express their condolences to the Shias. And the Americans, who often get blamed by Sunnis and Shias alike for Iraq's misfortunes, seem so far to have escaped retributive wrath.

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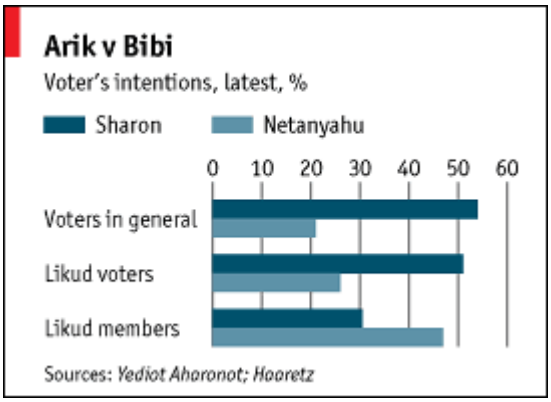
Israel

A question of timing

Sep 1st 2005 | JERUSALEM
From The Economist print edition

Binyamin Netanyahu launches his leadership bid



WHY now? Every time Binyamin ("Bibi") Netanyahu does something these days, people ask the same question. Last month he quit as finance minister, in protest against Israel's "disengagement" from the Gaza strip, just a week before it took place. And this week he launched a bid for the leadership of the Likud party and eventually of the country, months before he needed to.

Mr Netanyahu was prime minister from 1996 to 1999, and most Israelis guess that one day he will be again. A general election is due by November next year, and a poll last week in the *Haaretz* newspaper showed he would easily beat Ariel ("Arik") Sharon, the incumbent, in a primary held among Likud's 152,000 members. Even if Mr Sharon's fortunes change by then, his age—77 to Mr Netanyahu's 55—means that time is on the younger man's side; he could easily wait through another government, and in Israel's dull political firmament he has few real challengers.

Yet he has chosen now to harness the Likud membership's fury with Mr Sharon, who reneged on an election promise to hold on to Gaza, then forced the plan through against the no votes of most of the party in an internal referendum and one-third of its members of the Knesset, Israel's parliament. Though a party leadership ballot is not due until April, the central committee, due to meet on September 25th and 26th, is expected to advance it—perhaps to as soon as November. That would almost certainly trigger early elections. It would be the first time an Israeli party in power voluntarily cuts short its mandate.

That speaks of its sense of betrayal by Mr Sharon. Mr Netanyahu is reaching out to the right, trying to convince it that the betrayal will continue and that only he will safeguard the party's conscience and values. Touring Maale Adumim, the biggest Israeli settlement in the West Bank, he accused Mr Sharon of not doing enough to create an unbroken strip of settlement between it and Jerusalem, which both Israelis and Palestinians cherish as their capital. Meanwhile Mr Sharon, who was also expected to swing rightwards after the Gaza pull-out to mollify his critics, is instead adding grist to Mr Netanyahu's mill. While painting his challenger as irresponsible, whimsical and

prone to panic, Mr Sharon now says that any future peace deal with the Palestinians would indeed mean giving up more West Bank settlements.

But nobody has ever doubted that by this he means outlying ones, not the big blocks like Maale Adumim, now almost a suburb of Jerusalem protruding eastwards into the West Bank. (He even got a small boost this week when the residents of an isolated West Bank settlement asked to be relocated into Israel for their own safety.) And his rubbishing of Mr Netanyahu—who as an energetic, reformist finance minister somewhat repaired his reputation after an ineffectual stint as prime minister—will resonate. But having led the Likud's Knesset rebellion against the Gaza pull-out, at the last minute Mr Netanyahu voted for it, and allocated the budget for compensating the evacuated Gaza settlers without demur. He threw a few spanners in the works later on, but resigned only when the pull-out looked like a virtual fait accompli.

So why now? Perhaps going earlier would have jeopardised his reforms, and going later would have lost him any chance of appealing to the right. Likewise, announcing a leadership bid now, in the wake of the Likud poll, may have been an attempt to catch Mr Sharon at his weakest.

Still, to most people it makes Mr Netanyahu look like a naked political opportunist. And the Gaza pull-out went unexpectedly fast and smoothly, boosting Mr Sharon's support. What is more, though paid-up Likud members are against Mr Sharon, a poll in *Yediot Aharonot*, Israel's most popular daily, finds that Likud voters and the electorate at large would both choose him over Mr Netanyahu by a big margin. He will also enjoy the fawning of world leaders at a UN summit this month, returning home just before the Likud sets a date for the primaries.

That presages a tense showdown. Mr Sharon could run in the primary, hoping that a lot of Likud members will swallow their anger and vote for him as most likely to get the Likud into government. Or he could split the party, form his own with the dissenters and get into government with a centrist coalition including Labour and Shinui, the leftist parties that backed him over the disengagement plan. But that is a gamble too. There is no disengagement plan now, and nothing else visible that would hold such a ragbag coalition together. Moreover, the Likud might outsmart him by calling a no-confidence motion in the government, forcing an election before he has a chance to form a party.

For Likud members, this is a moment of truth. Losing Mr Sharon either way could mean political suicide. Will the instinct for self-preservation trump the desire for revenge or the need to maintain values; and do those values really include holding on to every West Bank settlement? Much will depend, however, on how things go in Gaza. Despite several recent killings of Palestinians by Israeli civilians and soldiers, the militant groups in Gaza have been muted in their response. (A cell from the West Bank was said to have been responsible for a botched bus-bombing in southern Israel.) Hamas, the main Islamist party, is expected to try to keep things that way at least until January, when Palestinian elections will be held. The level of violence in the coming months will determine how far any would-be Israeli leader has to lean to the right. Either way it will be a test of nerve—and Mr Sharon's is unquestionably the steelier.

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Iran

A gloomy new government

Sep 1st 2005 | TEHRAN
From The Economist print edition

The new president chooses his team

Get article background

“SERVING the Iranian people”, intones Iran's new conservative president, “is more worthy than lording it over the world.” Less than a month after he was sworn in, Mahmoud Ahmadinejad's already familiar pieties are looking like admissions of weakness. Last week, after making room in his cabinet for several nominees of the parliament, he watched, infuriated, as the same deputies withheld votes of confidence in four of his own nominees. A former mayor of Tehran, Mr Ahmadinejad is a newcomer to Iran's treacherous national politics. It shows.

The president had seemed blessed after he was elected in June to replace Muhammad Khatami, Iran's hesitantly reformist president of the previous eight years. For the first time since the late 1980s, all segments of the state seemed united in support of the same (admittedly woolly) conservative principles, of anti-Americanism abroad and the promotion of revolutionary Islamist values at home. But the conservatives, it turns out, are riven by personality. To be sure of passing legislation, Mr Ahmadinejad needs the support of two rival conservative factions in parliament. The supreme leader, Ayatollah Ali Khamenei, is an exacting patron.

Like Mr Ahmadinejad, who is 48, the new cabinet is young; several of its members served, as he did, in the ultra-ideological Revolutionary Guard. But loyalties are split. The imprimatur of Mr Khamenei, who dislikes cultural liberalism and uppity journalists, may be detectable in the appointment of a hardliner to head the culture ministry, which oversees the press, and in the appointment of two clerics with questionable human-rights records to run the interior and intelligence ministries.

The president may not be able to pursue his declared goal of social justice with the energy he would like. After campaigning on a dirigiste economic platform, he has mysteriously entrusted the economy to a free-marketeer, Davoud Danesh-Jafari. Cutting unemployment is a priority for Mr Ahmadinejad, but Mr Danesh-Jafari's talk of privatising state assets could put more people out of work in the short run. And parliament's rejection of the president's nominee to be oil minister will prejudice his chances of transforming Iran's most crony-ridden and important ministry. The president has three months to propose fresh nominees for this and other posts.

In foreign affairs, there will be none of the conservative-versus-reformist disharmony that marred Mr Khatami's presidency. But the new man is unlikely to enjoy more influence in foreign relations than his predecessor did, especially now that Iran, having ended a nine-month freeze on all work to develop a nuclear fuel cycle, risks being referred to the UN's Security Council. Ali Larijani, Iran's new nuclear negotiator, and Manuchehr Mottaki, the new foreign minister, both take their orders from Mr Khamenei. Both are considered more hardline than the men they replaced. For his part, the prickly Mr Mottaki is unlikely to maintain the rapport his predecessor enjoyed with Jack Straw, Britain's foreign secretary.

“The government will be tough on the elite and soft on the masses,” predicts a local pundit. That would mean more censorship of films and books, yet continued toleration of the unIslamic dress and morals that have become common in big cities. But the president will at least be able to dole out some of the record $70 billion in foreign exchange that Iran, thanks to high oil prices, expects to earn over the year to March 2006. Indeed, one of the cabinet's first acts after it convened last week was to set up a fund to help young people trying to get married and find jobs and housing.

And what of the reformists, those men (mostly) who populated Iran's political life for the past eight years and whose legacy is now in doubt? Mr Khatami plans a dignified retirement. A former culture minister has gone into exile; Mr Mottaki's predecessor as foreign minister has his eye on a top job in a university; others talk hopefully of regrouping. But there is little sign of them recovering power any time soon.

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Mauritania

An awkward friend for America

Sep 1st 2005 | LAGOS
From The Economist print edition

Why a new regime made the Americans nervous—at first

ON THE face of it, the West African state of Mauritania, bridging the Arab countries of North Africa with sub-Saharan Africa, offers little to the United States. It has an Atlantic coastline, an awful lot of desert and only 3m mainly very poor people. Yet there was concern, even if not exactly panic, in Washington when the president, Maaouiya Ould Taya, was toppled last month in a bloodless coup.

The concern is because Mauritania had forged a new role for itself as a frontline state in America's global war against terror. President Taya had made it an important country in an American-led regional coalition of eight others committed to taking on Islamist extremists thought to be at large in the Sahara desert. America may well spend up to about $500m in the region on the plan, and Mr Taya himself had become a keen ally. Mauritania was one of only three of the Arab League's 22 countries to have diplomatic relations with Israel. But Mr Taya's fate demonstrates the perils of West African governments embracing America too tightly.

The president, who seized power 21 years ago, had long been unpopular at home for his repressive regime, and had already survived several coup attempts. His dwindling support was further eroded, in a mainly Muslim country, by his zealous crackdown against militant Islamists. The main threat he cited in justification was the Salafist Group for Preaching and Combat, formed in Algeria in 1998 and allegedly linked to al-Qaeda. It kidnapped 32 Europeans in the Sahara in 2003.

In June, Mr Taya made a big fuss over an attack on a Mauritanian barracks near the Algerian border, in which he said 15 soldiers were killed. He blamed the Salafists and probably exaggerated

the number of attackers, typifying the keenness of governments in the region to court America by playing on fears that al-Qaeda may be spreading through West Africa. Mr Taya also used the attack as a pretext for another round-up of clerics.

That provoked a backlash. For some, the final straw had been a visit by Israel's foreign minister to Mauritania in the spring; for others it was Mr Taya's overreaction to the attack in June. One of the first moves of the army officers who overthrew him was to free 21 jailed Islamists.

The Americans fear that Islamist terror could spread from the Sahara into the oil-producing coastal countries of West Africa. The Gulf of Guinea is expected to provide about a quarter of America's oil in the next decade. Nigeria, part of the new regional security club and with half its population Muslim, is already America's fifth-largest supplier. Self-styled “Taliban” militants attacked security forces twice last year in Nigeria's remote north-east. In June, the American consulate in Lagos was briefly closed in response to an apparent threat.

But some doubt the reliability of the information the Americans get about Mauritania's Salafists, much of it from Algerian intelligence. Others worry that American support for harsh rulers like Mr Taya has deepened popular resentment against Saharan governments. “The net effect is that the Sahara has become a tinderbox,” says Jeremy Keenan, a Saharan-affairs expert at Britain's University of East Anglia.

So far, in Mauritania, the Americans have been lucky. After condemning the coup and suspending military aid, they quickly started talking to the new regime—once it promised not to change foreign policy too much. Perhaps they should now try boosting the economy.

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Lebanon

Closing in on the killers

Sep 1st 2005 | CAIRO
From The Economist print edition

A spate of arrests raises the rare hope that justice will be done

THE country is sadly used to bombs and assassinations, but sadder still, unused to seeing killers brought to justice. So, despite a swirl of accusations since the killing on February 14th of Lebanon's former long-serving prime minister, Rafik Hariri, an event that sparked popular revolt against decades of domination by Syria, this week's arrest of four top Lebanese security officers (and some lesser fry) was a pleasant surprise.

The dawn round-up appeared to bring the UN team investigating Mr Hariri's murder closer to a conclusion long suspected by many Lebanese: namely, that their own shadowy intelligence agencies had a hand in the crime. The detained men include the recently deposed chiefs of general security, internal security and military intelligence, as well as the serving commander of the Republican Guard brigade. All had close ties to Syria, whose troops bolstered and bullied successive Lebanese governments until international opprobrium forced their withdrawal earlier this year.

Even if charges are not pressed immediately, the arrests put teeth into the investigation and may signal an end to the culture of impunity that long shrouded the Syrian-backed intelligence apparatus. The move also raises pressure on Syria itself, which UN officials accuse of failing to co-operate fully with the investigation. Despite assurances from President Bashar Assad, it has so far not allowed direct questioning of at least five officials sought by the chief investigator, Detlev Mehlis, a German prosecutor experienced in terrorism cases.

The arrests have also spotlighted the last remaining pillar of Syrian influence in Lebanon, the country's president, Emile Lahoud. It was Syria's insistence last year on forcing an extension of Mr Lahoud's term that galvanised the Lebanese opposition. Led at first by Mr Hariri, the movement was strengthened after his death by a great groundswell of popular disgust that swept other Syrian protégés out of power and ushered in the UN's sleuths. Mr Lahoud, who appointed the detained security bosses in the first place and has ignored calls to sack the now-implicated chief of his own guard, cannot yet be constitutionally ousted but faces near-total isolation.

Still, the new government headed by Fouad Siniora, drawn from the old “opposition”, has yet, despite a strong parliamentary majority and international backing, to assert full control. A spate of bombings since Mr Hariri's death, as well as vicious infighting, has shaken confidence in Lebanon's ability to pull itself together. A procession of ministers, politicians and journalists has made its way to Paris in recent weeks, largely propelled by fears that they may still be targets for assassination. Mr Mehlis's headquarters, in a hotel overlooking Beirut, has been reinforced with sandbags and extra checkpoints. The UN investigator is due to present a final report on September 15th. Mr Mehlis may have to extend that deadline.

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Economist.com WORLD EUROPE

Russia and its regions

Beyond Siberia

Sep 1st 2005 | VLADIVOSTOK AND YUZHNO-SAKHALINSK
From The Economist print edition

The unintended consequences of the Kremlin's power grab over Russia's regions

IN FINE August weather, Vladivostok's grimy beach and rickety fairground are thronged. Children queue for reindeer rides. Tourists promenade in what was once a tsarist fort, then a closed Soviet city, but now feels freer than Moscow, seven time-zones to the west. Sergei Darkin, governor of the Primorsky region, and his close ally Vladimir Nikolaev, Vladivostok's young mayor, seem to be doing a better job than the corrupt ex-communist bureaucrats who run much of Russia.

Yes, but. Mr Nikolaev was elected only after his main rival was wounded in a grenade attack, then disqualified from last year's election. “They said I eat children for breakfast,” says the mayor of allegations about his criminal past. When your correspondent says that no, he himself has never been in jail, the mayor, who served time for violent crime, retorts that he “did not live in Russia and have to defend [his] business in the 1980s and 1990s.”

Like the north Caucasus, Vladivostok, Primorsky and the rest of the Russian far east were incorporated late into the Russian empire. Also like the Caucasus, the challenges that local bosses pose to Russia's government are peculiar to the district's geography and history. But they are also acute versions of the wider problems the Kremlin faces—and causes—in its handling of Russia's regions.

Soon after the bloody tragedy in Beslan a year ago, President Vladimir Putin announced that governors would be appointed by him, rather than being directly elected. This was the latest of Mr Putin's measures to take back powers that his predecessor, Boris Yeltsin, had ceded to the 89 regions (several mergers are pending). As justification, the Kremlin conjured up the spectre of Russia's violent dissolution. The corruption and ineptitude of many governors almost vindicates Mr Putin's approach—until you look at his appointees.

The first was Mr Darkin, whose reputation, though less dark than Mr Nikolaev's, is still shady. It is true, says Mr Darkin, who submitted himself for re-approval by Mr Putin before his elected term expired, that the new way is less democratic. But, he adds, it is more effective: with direct elections, you spend too much time shaking hands, as in America. Other governors have been kept on after suitable obeisance. In a few cases, Kremlin choices have been foisted on regions with which they have little connection.

One idea in Russia's far east is to unload responsibility for remote regions on to pliant billionaires. Roman Abramovich, owner of Britain's Chelsea Football Club, was set to quit as Chukotka's governor when his term expired later this year. But, perhaps to prove that it can make appointments without reference to a governor's wishes, as well as to voters', the Kremlin seems keen to keep him on. Mr Putin's envoy in the district (such envoys are another part of the emasculation of the governors, as was ejecting them from the upper house of the Russian parliament) has suggested that Victor Vekselberg, another tycoon, might become the governor of Kamchatka. The common denominator, which trumps even criminality, is loyalty.

A second strategy to bind the regions to Moscow is to offer giant industrial projects. One is a mooted pipeline to carry Siberian oil to the Pacific coast near Vladivostok. But the project's popularity has declined because of the choice of an environmentally-sensitive bay as the site of the oil terminal. There are whispers of warped motives. “All our Russian governors are just businessmen,” laments one Vladivostok environmentalist. Another mega-project is on Sakhalin island.

Like the American west, Russia's far east has long been a frontier of opportunity. But it has also been a punishment, to which many went unwillingly—and left when they could. More than half the population of Chukotka and Magadan have fled the permafrost since the Soviet Union's collapse. The population of Sakhalin—which Chekhov, visiting when the island was a giant prison camp, considered the most depressing place in Russia—has fallen by around a quarter. But in 1999, the most advanced of the consortia drilling for oil and gas off Sakhalin began producing it. Now, says Sergei Osipov, the region's deputy governor, who also has a fishy reputation, “Only a very lazy person doesn't have a job on Sakhalin.”

Maybe; but the island is developing into a caricature of petrostate inequality. Its dismal towns are still dominated by statues of Lenin; factories built by the Japanese, who occupied the south

between 1905 and 1945, are in disrepair; much of the fishing fleet is rusting in the water. In the north, says one worried islander, many people spend their time “poaching, drinking and killing each other”.

Sakhalin's main gripe is that almost all the Russian share of the revenues from energy deals goes to Moscow. Gennady Zlivko, the mayor of Korsakov, a town close to a huge oil-and-gas terminal being built at the island's southern tip, rages at the “nonsense” of his town having to burn coal to heat its houses. The resentment is currently focused on foreign oil companies, but that could change.

The Kremlin's combination of tightening and flailing carries risks. The big local fear in the far east is of China. Hordes of Chinese are said to be swarming across the Amur river, with maps showing the Russian far east as Chinese territory, to fill empty spaces. In fact, except on construction sites, and in the bigger markets where they hawk cheap clothes, fake furs and just about everything else, the Chinese are less obtrusive in Vladivostok than are ethnic Koreans in Sakhalin, descendants of the slave labourers once brought there by the Japanese. And the Chinese are a longstanding fixture: without them, wrote one 1897 visitor, “civilised life would simply cease to exist”. Governor Darkin says that any social problems the immigrants cause are no bigger than in London or New York.

The real danger is subtler. Mr Putin was this week due to meet relatives of Beslan victims, who are outraged by a lack of answers to basic questions about last year's atrocity (see article). Since then, terror and instability have permeated the north Caucasus, aggravated by the lawlessness of the security services. In a different way, the far east may also realise the Kremlin's prophecy—and drift farther from Moscow.

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Beslan one year on

Parental grief

Sep 1st 2005 | ENGENOI, CHECHNYA
From The Economist print edition

Memories and lessons from last September

Get article background

HIS son Nurpashi, the only surviving hostage-taker from Beslan, has just gone on trial. But Aburkash Kulayev feels no need to apologise for the deaths of over 300 people at Beslan a year ago. “It's cruel. Of course we feel their pain,” he says in his cottage in the Chechen village of Engenoi. “But whatever happened, happened. In Chechnya, thousands of children have died.”

Almost every family in Chechnya has losses from two wars with Russian troops. One of Mr Kulayev's sons was killed by the Russians before two others went to Beslan. One died in the bloodbath: Nurpashi was taken alive. In Ingushetia, the parents of another hostage-taker, Rustam Atayev, display a photograph that may explain what led him to terrorism. The picture is of his dead 11-year-old brother, Ibraghim. The father, Solongiray Atayev, says that Ibraghim vanished from the streets of Grozny in 2002. He was found with two other boys in a shallow grave, all naked, their heads split open.

EPA

Unconsoled

Immediately after Beslan, Russian officials tried to put the blame on foreign terrorists. They said the hostage-takers included Arabs and a black African. But although Islamic jihadists are indeed making advances in the region, the roots of Beslan, as of instability across the north Caucasus, are local: the conflict in Chechnya, corruption in government—and brutal lawlessness within the security forces. And the Russian government is doing little about these.

“Russia doesn't seem to have a will, a plan or strategy,” comments Timur Akiev at Memorial, a Russian human-rights organisation. “You can solve all these problems if you start with Chechnya, but if you don't solve that first then resolving the others will be impossible.”

Bereft parents in Beslan have no sympathy for the hostage-takers' families. “Shoot them,” demands one. But their anger is as fierce against the Russian authorities, including President Vladimir Putin, whom they accuse of incompetence, negligence and heartlessness. This week, the Beslan Mothers Committee at last had the chance to meet Mr Putin. Their message is in some ways similar to that of the hostage-takers' parents: to avoid more Beslans, fix Russia.

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Turkey and the European Union

Bazaar bargaining

Sep 1st 2005 | ANKARA
From The Economist print edition

More troubles over the conditions for starting Turkey's EU entry talks

Get article background

IT WAS only in December that European Union leaders agreed to open membership talks with Turkey on October 3rd. Yet as the date looms, doubts over whether the talks will start keep recurring. The Turkish foreign minister, Abdullah Gul, says that this is not “because of any fault of my government, but rather because of certain countries within the EU.” He told *The Economist* last week that “should they [the EU] propose anything short of full membership, or any new conditions, we will walk away. And this time it will be for good.”

Mr Gul's tough remarks follow weeks of diplomatic clashes. The French president, Jacques Chirac, said that Turkey must recognise Cyprus before starting talks. The leader of Germany's Christian Democrats (and the likely winner of this month's German election), Angela Merkel, said once again that the talks should lead only to “a privileged partnership”. Turkey's prime minister, Recep Tayyip Erdogan, is fuming. “If they provoke him any further he may well explode,” said an aide.

It was in this highly charged atmosphere that EU foreign ministers this week began two days of informal talks. The Turks are arguing that, since late July, when they signed a protocol extending their customs union with the EU to the ten new members that joined last year, including Cyprus, there has been nothing more to discuss. But there is a row over the small print. Mindful of nationalist sentiment at home, Turkey decided to issue a declaration, after signing the protocol, that it would recognise Cyprus only after a comprehensive settlement for the whole island was reached.

EU legal experts noted that the declaration does not rule out recognition. Yet, largely at the urging of the French, the EU is now preparing to make a counter-declaration. Its precise wording was still being negotiated at mid-week. The Turks hope that the British, who hold the rotating EU presidency, will devise a formula acceptable to them (and to their public). But the Greek-Cypriots say they too must be satisfied. One knotty problem may be Turkey's continuing ban on Cypriot aircraft and ships entering its airspace and ports.

Even the counter-declaration may not be the end of the matter. Should membership conditions be stiffened in the framework document for the negotiations, Turkey's parliament may not approve the extension of the customs protocol next month. Turkey complains that it is being subject to tougher rules than any previous candidate. Not only is it required to harmonise its laws; it must also demonstrate its implementation of them, for every one of the 35 “chapters” in the framework.

Haggling over the words in the framework is likely to continue right up to October 3rd, echoing the drama last December when wrangles over Cyprus almost wrecked the summit deal to begin talks. “No one should expect Turkey to make any concessions this time,” says Mr Gul. “We have stuck to our side of the bargain, the EU should stick to theirs.”

Economist.com WORLD EUROPE

The German elections

Left dilemmas

Sep 1st 2005 | BERLIN
From The Economist print edition

As the centre-right scents victory, bickering starts on the left

Get article background

AS MANY as three parties are vying for the votes of left-leaning Germans on September 18th. That should offer enough choice to entice even habitual non-voters. Yet it is unlikely to bring the left victory. Most polls say that the centre-right Christian Democrats (CDU), with their partner, the Free Democrats (FDP), will beat the three left parties (the Social Democrats, or SPD, the Greens and the Left Party).

That is partly because the left is weak and divided. It is split among social democrats, leftish-liberals and socialists, partly thanks to its two periods of government since the war. In the 1970s, Chancellor Helmut Schmidt's refusal to accept the environment as an issue led to the formation of the Greens. Now Chancellor Gerhard Schröder's economic reforms have produced the Left Party, a blend of disaffected SPD members and ex-communists.

These defections have shrunk the SPD to a core. At this week's party congress, leaders insisted all was well. But in private some are giving up, and criticising Mr Schröder's campaign. Unless his televised debate with the CDU leader, Angela Merkel, on September 4th gives Mr Schröder an unexpected boost, the growls will get louder. In effect, debate over the post-Schröder era has begun. The SPD has two options: to move to the left, re-establishing its credentials as a people's party, or to stay the course set by Mr Schröder and hope for a “grand coalition” with the CDU.

The first option will be more likely if the SPD wins less than 30% of the vote. The more it gets above that figure, the better the chances of the second option. The argument will be fierce, not least because it is a clash between generations as well as between different shades of trade unionism. A grand coalition with the CDU could produce more defections to the Left Party and, maybe, a split in the unions.

The SPD's first offspring, the Greens, are not plagued by such infighting. But the party is not free of tension. Its leaders are pragmatic and professional, but the party base is more radical and left-leaning—which is why the Greens' election programme is leftish. There will be tussles for a dwindling number of top positions. If the Greens are not in the federal government, there will be no Green minister anywhere in Germany, even at state level.

The Greens' biggest challenge is to retain support even if they have little chance of power. Another coalition with the SPD is unlikely, at least at federal level. The time for an alliance with the CDU has not yet come (though there is a slim chance of one in Baden-Württemberg next March). Yet the Greens are not doomed, as some have suggested, even when Joschka Fischer, the popular foreign minister, eventually retires. Green voters have shown themselves surprisingly loyal, particularly in big cities. And the party has more capable politicians in the politically critical 40-55 age range than its rivals.

The fate of the Left Party is the hardest to predict. It had long been expected that the ex-communists of the east and a new party from the west might team up to reactivate two well-known politicians, Gregor Gysi and Oskar Lafontaine. The big surprise was how well the party did at first, exceeding 12% in early polls. Yet it has since dropped to around 8%, revealing the fragility of its support. Perhaps voters in eastern Germany, its stronghold, returned from holiday with less interest in a protest vote. Certainly many have a problem with Mr Lafontaine, a former SPD boss and noted bon vivant. Even his comrades criticised him for holidaying in a €3,000-a-week ($3,700) villa in Majorca.

Political tensions between the eastern and western branches of the Left Party are mounting. To smooth them over, the party staged a joint congress last week as a big east-west socialist love-fest. Mr Lafontaine went so far as to kiss a former communist from the east, Hans Modrow. Yet reactions to the Left Party's campaign poster tell a different story. Many interpret the sight of a beaming Mr Lafontaine towering over a fawning Mr Gysi as a symbol of the west's dominance over the east. Conversely, some idealistic western lefties worry that their job is merely to give ex-communists a foothold in their part of Germany.

All three left-of-centre parties are likely to remain a fixture in the political landscape. The question will then be whether they can come together to form a governing coalition—perhaps in 2009, if a government led by Ms Merkel fails to be re-elected. It is possible, and it is clearly what Mr Lafontaine and Mr Gysi want. Yet for such a coalition to be formed, the Left Party would have to be less populist, the SPD more left-wing and the Greens more social-democratic. Such big changes might have to await a new generation of politicians. It is hard to imagine the SPD's present leaders ever working with Mr Lafontaine, whom they see as a traitor.

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The European Union and China

Textile trouble

Sep 1st 2005 | BRUSSELS
From The Economist print edition

How the EU got into difficulty over Chinese clothing

AP

The bras pile up

AN EXAMPLE of the European Union at its finest: that was how Dominique de Villepin, France's prime minister, greeted the deal in June to limit Chinese textile exports to the EU. Ten weeks later, only a diehard Europhobe could be satisfied.

At the time, the EU's trade commissioner, Peter Mandelson, said that the deal (which caps annual growth in ten categories of textiles to 8-12.5%) "will give players on both sides clarity, certainty and predictability." Now, retailers are livid after more than 80m items of Chinese-made clothing were impounded because they exceeded the quota. Licences to import a further 120m pullovers—almost twice the quota for the rest of the year and four times total sales in 2004—have been granted by EU governments. These licences were issued in the month between the agreement's signing (June 11th) and the announcement of regulations (July 12th).

There is plenty of blame to go round. The European Commission could be faulted for letting a month slip between signature and implementation—a gap through which retailers stampeded. National governments (including those that most wanted protection for textile makers) could be blamed for ladling out so many import licences. The bigger fault lies in cack-handed efforts to gerrymander the market in the first place.

Whoever is to blame the result has been ambiguity, not clarity. It has left the EU in the undignified position of begging for China's help in healing a self-inflicted wound. In June, China's official Xinhua news agency called the deal "a new paradigm for settling [trade] differences". Its commerce minister, Bo Xilai, said that "the Chinese government appreciates the EU's sincerity in solving trade disputes with China through dialogue and consultation, instead of taking unilateral action" (like you-know-who).

Yet when EU negotiators asked the Chinese to make it easier for them to unblock the goods by treating them as part of next year's quota, the Chinese balked. Agreeing to export restraints was hard. Agreeing to further restrictions just two months later because of European chaos is harder. All in all, the affair has demonstrated neither the virtues of managed trade, nor the EU's conviction that its partnership with China is highly valuable because, in Mr Mandelson's words, "we need to manage China's integration into the global economy in a sensible and smooth way."

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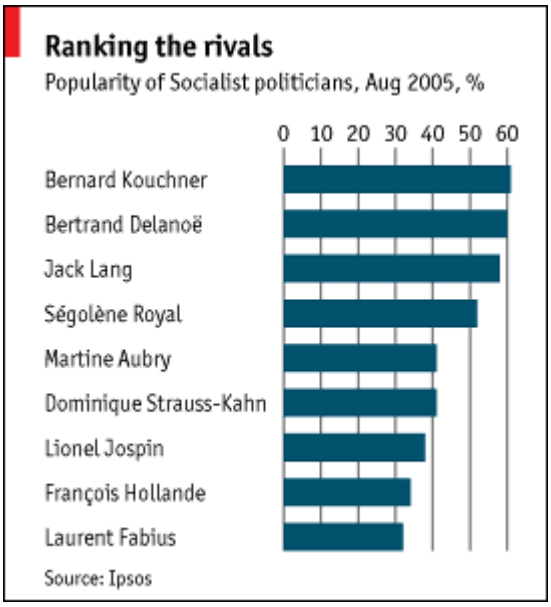
The French Socialist Party

Of runners and riders

Sep 1st 2005 | PARIS
From The Economist print edition

The Socialists remain divided and in disarray—and without a clear leader



Get article background

WITH an unpopular Gaullist president and a sour French anti-capitalist mood, the Socialist Party ought to be confident. Instead, at last weekend's summer school in La Rochelle, party leaders queued up to declare their personal ambitions, leaving an impression of confusion and division—just what François Hollande, the party leader, wanted to avoid.

Unity “is our most precious asset”, declared Mr Hollande, urging his comrades to refrain from personal politics. His words went unheeded. One by one, top Socialists declared themselves candidates for the 2007 presidential election. Mr Hollande, if he is re-elected boss at a party congress in November, will be one. Dominique Strauss-Kahn, a moderate ex-finance minister, said he would run—even if Lionel Jospin, a former prime minister, makes a comeback. Jack Lang, a popular ex-culture minister, said he was up for the job. So is Martine Aubry, mayor of Lille and architect of the 35-hour working week.

The problem with this “abundance of talent”, as Mr Hollande calls it, is its abundance of rivalry. These aspirants belong broadly to the same camp, close to Mr Hollande and in favour of the European Union constitution that voters rejected in May. Against them are the constitutional rejectionists, led by Laurent Fabius, another former prime minister. But this lot are divided too. Mr Fabius, a tax-cutting finance minister who now flirts with anti-globalisers and revolutionary communists, is distrusted by his fellow travellers.

At stake are not only the personal careers of a generation of top Socialists, but also the future direction of the French left. By most standards, France's Socialists remain unreconstructed. But those around Mr Hollande are modernisers, in favour of a “renovated socialism”. Some, such as Mr Strauss-Kahn, are less interventionist than others, such as Ms Aubry. But they share a pragmatic acceptance of market forces, after the 1983 U-turn away from the nationalisation and fiscal recklessness that began the Mitterrand presidency in 1981.

By contrast Mr Fabius, who as prime minister implemented many austerity measures at the time, now advocates a shift back to the left. The best alternative to the neo-Gaullist politics of President Jacques Chirac, he argues, is not a more moderate but a harder left. This week, he denounced those who favoured “a liaison between the left and centrism”, and called for a genuine left-wing alternative. Mr Fabius portrays himself as a realist, responding to the mood of the people. His detractors point to his naked opportunism and breathtaking party disloyalty.

In the short run, the balance of power between the two camps will be tested at a party congress in November, which will be like a mini-parliament. Mr Hollande and his allies are presenting a single motion, in the hope of scraping the majority that is needed to keep control of the party. If they succeed, they plan to designate a presidential candidate in late 2006. Under this scenario, Mr Hollande could stay as party head even if Mr Strauss-Kahn, say, became the official candidate.

Rival contenders for the party leadership have been unable to agree on a common motion. Mr Fabius's team will present one anyway—though the ex-prime minister has said that he does not want to be party head, hinting that he might cut a deal with a friend. But other motions are being prepared, for instance by Arnaud Montebourg and Vincent Peillon, two young radicals, as well as by Henri Emmanuelli, a left-wing firebrand. The last time Mr Fabius presented a motion, in 1990, he won 29% of members' votes. Unless he can do a deal with others, his adversaries say he would get half that now.

Most left-leaning voters are exasperated by the left's divisions. The prospect of the party tearing itself apart is even being raised. If Mr Fabius grabbed control, “Should we risk a split of the Socialist Party?” asked Bernard Kouchner, a popular former health minister and co-founder of Médecins Sans Frontières. “Yes. The time for superficial reconciliation has passed.” He added that the party needs to “confront the pseudo-Marxists and their worn-out utopias.” But if two heavyweight rivals stand, the upshot could be failure all round. In the 2002 presidential election, even without a split in the party, the left paid a heavy price for its fragmentation: the far-right Jean-Marie Le Pen evicted Mr Jospin in the first round.

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Making and marketing celebrities

The fame machine

Sep 1st 2005
From The Economist print edition

Britain's celebrity industry is more prolific—and more benign—than ever before

FASCINATION is universal for what Aaron Spelling, a prolific producer of American soap operas, once called “rich people having problems that money can't solve”. But the fascinated in star-struck Britain have no equal.

The country has a profusion of titles devoted to chronicling even the smallest doings of celebrities. Britons buy almost half as many celebrity magazines as Americans do, despite having a population that is only one-fifth the size. Celebrity news often makes the front page of British tabloid newspapers, providing a formidable distribution channel for stories about celebrity sex, drugs and parenthood. New figures from the Audit Bureau of Circulation show that the ten bestselling celebrity publications and ten most popular tabloids have a combined circulation of 23m.

Satisfying this voracious demand has turned what was once a shoddy, amateurish business into an entertainment industry in its own right. Its business model has two distinguishing features. First, celebrity has become the product—rather than just a device for marketing films or music. The “talent” (if that is the word) owes its standing chiefly to the celebrity machine and not to any particular gift. It therefore depends on the attentions of the press to make money. Second, celebrities, agents, photographers and picture desks have found that the most efficient way to create an endless supply of celebrity news is to work together. A business that used to be based on intrusion has discovered a preference for collaboration.

It is also expanding abroad. In the past few weeks, Northern & Shell has launched an American edition of *OK!*, a celebrity magazine that already has Australian, Chinese and Middle Eastern editions. EMAP recently launched *Closer* in France and already publishes a South African edition of *Heat*, a bestseller in Britain. And celebrity hounds who cut their teeth in Britain's competitive market are in demand abroad. The *National Enquirer*, a hard-nosed American scandal sheet famed for pushing back the boundaries of taste—and of free speech—was relaunched earlier in the year by a team led by Paul Field, formerly of the *Sun*, and stuffed with alumni of British tabloids and magazines.

Celebrity magazines were not a British invention. *Hello!*, which is still widely read but which has been waning of late, originated in Spain, where *¡Hola!* provided a hint of glamour to women under Franco's drab reign. Before that, magazines grew up around the film industry in America. Some reported what the studios wanted them to say; others, such as *Confidential*—which became the biggest-selling magazine in America in the 1950s—aimed to dish the dirt on the stars. And in Britain, celebrity news has been used to sell newspapers for more than a century. The *News of the World*, which gleefully reported aristocratic sex scandals in the 19th century, first appeared in the same year as Dickens's “A Christmas Carol”.

But modern Britain has given the gossip a new sophistication. Part of the secret has been to separate celebrity revenue streams. Julian Henry of Henry's House, an agency for celebrities, distinguishes between a celebrity's craft (such as singing, stripping or kicking footballs) and their

celebrity rating, which has a trajectory of its own, and often has an inverse relationship to the talent a famous person has, or once had. This second stream can often be more valuable than the first, and Britain's celebrity industry has become adept at creating and selling it.

Take, for example, Peter Andre and Katie Price, who are to marry later this month. The pop singer and the topless model, better known as Jordan, met when their careers were flagging, on a reality TV show—that essential new cog in the celebrity machine. They have sold rights to the wedding, built around a Cinderella theme, as an exclusive to *OK!* for a small fortune (a price, the gossip press says, that has irked Victoria Beckham, whose marriage to her footballer husband was covered by a million-pound contract). In the past such sums have been reserved for authentic stars such as Michael Douglas and Catherine Zeta-Jones. The deal included more than wedding snaps: over a year of the couple's life—from prenuptial nerves to the first birthday of the expected offspring—was bundled together and sold as a commodity. Ms Price, who once said the only book she had read was the story of the Yorkshire Ripper, has now signed a three-book deal with Random House.

Paul Ashford of Northern & Shell, the company that owns *OK!*, calls this stuff “relationship journalism”, and it is pretty easy to spot. The process has become so effective that the three celebrities who insiders say shift most copies of *OK!* have all been manufactured in this way. With celebrity stories able to have such a powerful effect on sales, it is unsurprising that their manufacture is not left to chance.

Modern celebrity in Britain is also more egalitarian. Tittle-tattle about dukes and duchesses is worth less than stories on ordinary folk, partly because ordinary folk make for more colourful copy. The *News of the World* boosted circulation by 250,000 (says the agency that sold the pictures) when it put the Beckhams on its cover last year after David Beckham was alleged to have had an affair.

Such cases show how celebrities' willing participation can come back to haunt them if they transgress. But this is less common than you might think: many of the celebrity pictures that look like plain intrusion into private lives are staged.

This is partly thanks to the profit motive. Many celebrities don't see why they should give away their image when they could make money from it. Darren Lyons runs a photography agency called Big Pictures that specialises in shooting celebrities through long lenses as if for a paparazzi picture. The profits from the picture sales are then split between the subject, the agency and the photographer. “We're almost known as the friendly paparazzi,” grins Mr Lyons from the high-backed, red-leather judicial chair in his office, a lion-skin rug spread across the floor. Collaboration allows celebrities to retain some control over choosing the pictures that appear.

Pressure to work together has also come from concern over European human-rights laws. Picture desks, which assume legal responsibility for a photographer's actions when they publish a picture, are worried that European law may have introduced something like a right to privacy. It is hard to know if that is true, since cases that have gone against the press are under appeal and the one case often cited to back up the idea—involving Princess Caroline of Monaco and a German publication—included royalty rather than celebrity. But the perception is enough to make editors risk-averse.

Of course, much old-fashioned muckraking still goes on. But the celebrity production line has taken some pressure off reluctant participants in the business. “Now people are famous for doing things that 15 years ago they would have tried hard to keep out of the papers,” says Max Clifford, a veteran of Britain's celebrity business. A blow to shame, perhaps. But not necessarily bad news.

Economist.com WORLD EUROPE

Recovering from terrorism

Panic attack

Sep 1st 2005
From The Economist print edition

Most people will get over the London bombings without psychological help

FOR most Londoners, the horrific bombings of July 7th and the failed attacks of July 21st caused little more than fleeting nervousness, a long walk home and a few weeks' frustrated commuting as security alerts jammed the public transport system. But those who were more vulnerable or closer to the explosions may suffer deeper psychological wounds. The National Health Service would like to know more, which is why it has embarked on an ambitious and novel plan to screen Londoners for trauma.

Until recently, the favoured response to horrific events was swiftly to “debrief” as many people as possible, encouraging them to talk about their experiences and feelings. Some debriefing still goes on, but the experts have turned against it. Chris Brewin, a psychologist who is involved with the London project, says there is no evidence that rapid debriefing works and some evidence that it is actually harmful. “Most people don't need it, and those who do need something more,” he says.

This time, psychologists have held back for almost two months. They have also avoided the blanket approach used in America after the attacks of 2001, when counsellors stopped people in the street. Instead, witnesses to the bombings will be screened for severe trauma. So will anyone who was treated for an injury or reported anxiety to their doctor. Those who seem particularly upset will be referred for 6-12 hours of therapy.

How many are likely to be troubled? Sandro Galea, who studies the epidemiology of trauma at the University of Michigan, polled the residents of central and lower Manhattan a few weeks after the World Trade Centre was struck. He estimated that 7.5% had post-traumatic stress disorder (PTSD) as a direct result of the attacks. That is not very many, considering that the normal rate of PTSD in America is about 3.5% as a result of everyday things, such as car crashes and muggings. A similar study of Madrid after the train bombings of March 2004 found rates of terrorism-related trauma only about one-third as high as in New York, which may hint at the extent of the problem in London.

Another bit of good news is that people quickly get over their fears. By spring 2002, just 0.6% of people in central and lower Manhattan appeared to be suffering from PTSD as a result of the attack. That ability to recover swiftly from trauma is why experts now reckon it is unwise to urge people to relive their experiences.

Less encouragingly, Dr Galea's latest research suggests that people may become more troubled after six months, as the supportive phone calls stop and the anniversary of the disaster looms. The number contacting Project Liberty, which organised counselling in America, surged in September 2002. Worse still, it is harder to predict who will still be suffering a year or two after the event. By that point, stresses such as job loss and divorce may compound the trauma of terrorism. Memories of the atrocity will become more diffuse, but will linger nonetheless.

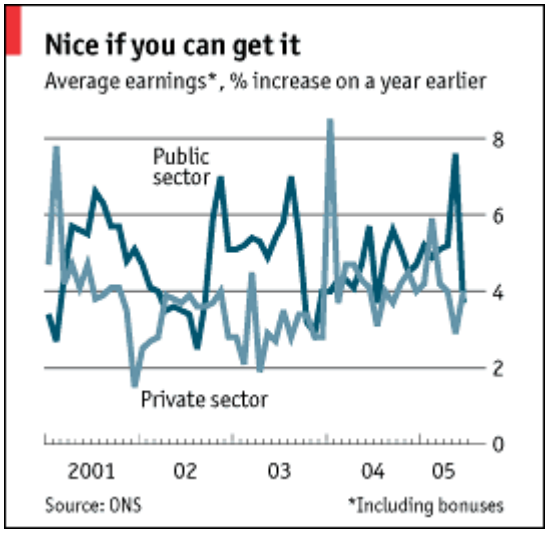
Economist.com WORLD EUROPE

Public-sector pay

Safety first

Sep 1st 2005
From The Economist print edition

Public-sector pay is high and rising



WORKERS in the private sector, worried by job insecurity, long days and stress, might want to consider a career in government service instead. Hours are shorter, holidays longer and pensions are funded by the taxpayer instead of depending on the whims of the stockmarket. Best of all, the salaries are higher.

Last month the Chartered Institute for Personnel Development concluded that public-sector workers had enjoyed bigger pay rises than their private counterparts every year since 2001. Public-sector pay increases have outstripped those in the private sector in nine of the past 12 sets of monthly figures.

According to a new report from Income Data Services (IDS), an employment research outfit, much of the increase relates to new long-term pay schemes that are coming into effect across big swathes of the public sector. These are designed to modernise antiquated and arcane pay systems and equalise rewards across similar jobs. Inevitably, that means equalising upwards. But there is another, more interesting reason for the growth: Labour's fondness for using private-sector methods to improve public services.

Much was made of the figures for the year to May, which showed public pay up 7.6%, compared with only 3% for the private sector. Yet IDS points out that much of that was due to the bonuses paid by the Royal Mail to each of its 160,000 workers for meeting service targets. If those are stripped out, the rate of increase falls to 5%. Rewarding workers for good performance is a standard private-sector tactic. Similar schemes exist for doctors who meet Department of Health targets.

The report also cites the fashion, especially in health and education, for contracting out services to specialist companies, a favourite tactic of private-sector managers looking to trim costs. Many of the lowest-paid public-sector jobs—such as cleaning hospitals and providing school meals—have been outsourced to private firms. Perversely, such contracts have the effect of making salaries appear to rise, since taking the poorest workers off the payroll moves average pay levels up in the public sector (and lowers them slightly in the private).

Other tactics have been adopted in education. Teachers are scarce for certain subjects such as maths, science, English and foreign languages. Since 2000 the government has given “golden hellos” of up to £4,000 ($7,211) for new teachers in these subjects. These are due to rise from September, reaching £7,000 for maths teachers and £5,000 for science teachers.

It is not just the rate of public-sector pay rises that causes grumbles, though. Median wage levels are now higher in the state sector than in private industry. The typical public servant earns £453 per week, compared with only £408 for a privately employed worker. And although the mean wage is slightly higher in the private sector (£509 per week compared with £500), that is due to the extremely high salaries paid to a privileged few.

But not all public-sector workers have reason to be content. The salaries paid to top doctors and civil servants pale next to the best packages on offer in private firms. Adam Crozier, Royal Mail's chief executive, is the only public-sector worker whose remuneration approaches that found in the upper echelons of private enterprise: he has earned more than £3m since joining the company in 2003. But he is hardly typical: he was poached from the private sector to run a state-owned enterprise. Some senior civil servants measure their salaries in hundreds of thousands of pounds, but that is small beer compared with what a top lawyer or a director of a mid-sized company can expect to earn. The real high-fliers make millions.

So workers in the private sector can comfort themselves with the fact that, although their median pay is lower, there is the possibility that they may one day reach the stratospheric rewards reserved for top performers. Those on the government's payroll, meanwhile, are trading opportunity for security.

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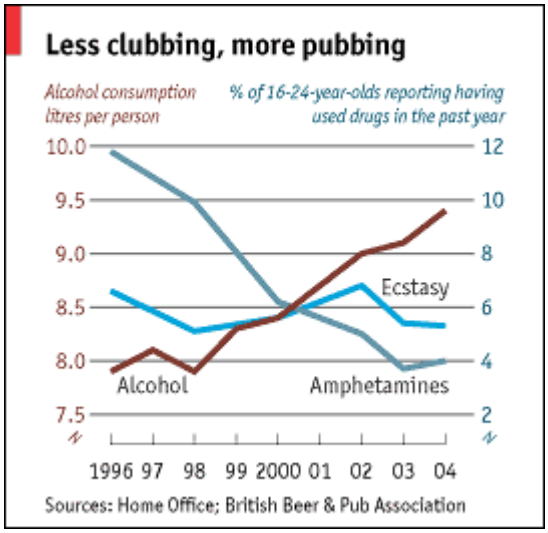
Economist.com WORLD EUROPE

Drink and drugs

Teenage kicks

Sep 1st 2005
From The Economist print edition

Young Britons are drinking more but popping less



TWENTY years ago, it was the football hooligan. Ten to 15 years ago, it was the raver. These days, the binge drinker is the symbol of lawless Britain. Tabloid newspapers report that young people are gripped by an alcoholic frenzy. Together with doctors, police officers and opposition politicians, they have lined up against the 2003 Licensing Act, which, from November, will permit some pubs to open later. This week magistrates weighed in, predicting an increase in domestic violence, assaults outside pubs and vomit in people's gardens.

Britain's drink problem is undeniable. While Americans and continental Europeans consume the same amount or less than they used to, with sobriety notably on the rise in France and Italy, Britons drink a quarter more alcohol than they did ten years ago. The average Briton swallowed 9.4 litres of pure ethanol last year (see chart).

Binge drinking is increasing most rapidly among young people. Robin Room, who follows the subject at the University of Stockholm, says that Britain has nurtured a “wet generation” like the one that emerged in prohibition-era America. The effects will be noted in coroners' reports: deaths from chronic liver disease among people aged 25-44 have increased almost ten times since 1970.

Meanwhile, though, other forms of hedonism are quietly declining. The mind-altering substances that moralists worried about a decade ago have fallen from favour. According to the British Crime Survey, the proportion of 16- to 24-year-olds who used amphetamines in the previous 12 months fell from 12% in 1996 to 4% last year. Ecstasy has also become less popular, which is surprising given falling prices: in many places, a pill now costs less than a pint of beer.

“It's a fashion thing,” says Matthew Atha, of the Independent Drug Monitoring Unit, which tracks drug users' preferences. He believes that young people are switching from illegal highs to legal ones as tastes change and messages about the dangers of ecstasy and other recreational drugs sink in. Government policies have also pushed hedonists towards alcohol. A crackdown on illicit raves in the 1990s coincided with looser planning regulations, which encouraged the growth of large pubs in city centres.

Licensing reforms will speed the trend towards old-fashioned intoxicants. Until now, most British pubs have been forced to stop serving alcohol at 11pm, forcing revellers to move on to the sort of venues where drink is expensive and loud music and pills are to be found. When pubs can stay open later, though, more punters will stay put. Mintel, a consumer analyst, reckons nightclubs will lose 12% of their customers by 2009.

Longer licensing hours will probably mean more drinking. But if the worst fears of the temperance lobby are realised, fewer pills will probably be popped. Britain may lose the fight against drink but win the war on drugs.

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Economist.com WORLD EUROPE

Pensions

A time to save

Sep 1st 2005
From The Economist print edition

Employers break ranks over forced saving for retirement

UNLIKE the rest of Europe, Britain has long relied upon a partnership between the state and employers to provide pensions. But in recent years, this voluntary approach has looked increasingly shaky as companies have taken fright at the risks involved in financing retirement benefits. At the end of November the government-appointed Pensions Commission will issue its long-awaited report on whether compulsion is now necessary.

Until now, employer groups have been adamantly opposed to a policy of forced retirement saving. “Compulsion is not the answer,” said Sir Digby Jones, director-general of the Confederation of British Industry (CBI) in May. “It would be viewed by both employers and employees alike as yet another stealth tax.” A month later, David Frost, director-general of the British Chambers of Commerce (BCC) said, “compulsory pension contributions are the last thing that UK employers need”.

However, the EEF, an influential employer group representing manufacturers, has now broken ranks. In a report published on September 1st, it backs the compulsory principle. “We no longer think that voluntarism will work,” says David Yeandle, the EEF's deputy director of employment policy.

As part of a general reform of pensions, the EEF calls for the introduction of compulsory retirement

saving in ten years' time. Employers and employees would initially each pay a contribution rate of 2% of pay. This joint rate of 4% would rise to 8% by 2025. The money would be put into a small number of low-cost private investment funds.

The Trades Union Congress, which has been lobbying for compulsion, naturally welcomed the EEF's conversion to the cause. Describing the report as “hugely significant”, Brendan Barber, the TUC's general secretary, said: “No longer can other employer organisations pretend that business is united.”

The disunity among employers will doubtless have some effect on the Pensions Commission and government ministers, but not as much as Mr Barber hopes. The EEF's backing for compulsion reflects the distinctive nature of its member firms. Employers play a more prominent part in pension provision in manufacturing than in some other types of private business (see chart). The worry for firms that already contribute to pensions is that they may be undercut by those that do not.

Mr Yeandle says that the EEF's members “feel increasingly that there needs to be more of a level playing field”. Surveys of its membership show rising support for compulsion among companies already providing pensions. In 2004 roughly two-thirds backed employer compulsion, up from a half in 1998.

By contrast, the membership of the BCC is more broadly based, with more small businesses. A survey of its member firms earlier this year found that half of them did not provide a pension contribution for their workers. The most important reason such employers gave was that they could not afford the extra cost.

The government will take note of the EEF's call for compulsion, but it will also pay heed to the CBI, the employer group with the most political clout. Like the BCC, the CBI is worried about the impact of compulsion on smaller employers. It fears that compulsion could allow the government to withdraw tax incentives that underpin private-pension provision.

The EEF's proposed timetable for compulsion, starting in 2015, could turn out to be more significant than its backing of the principle. When the government finally sets out its policy, it may prefer to threaten compulsion at a future point if firms fail to increase their pension provision. Whatever their disagreements, employers will continue to wriggle on the hook.

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Serial killers

First, do no harm

Sep 1st 2005
From The Economist print edition

Even mass murder is hard to detect

PA

Angel of death

IN 2000 Harold Shipman, a family doctor, was convicted of murdering 15 patients. The inquiry into the case blamed lax controls on opiate drugs, Shipman's weapon of choice in as many as 260 murders. As a result, Airedale General Hospital in West Yorkshire decided to audit its supplies—and discovered that it might be harbouring a serial killer.

A police investigation was launched in January 2003. Eventually a senior nurse at the hospital, Anne Grigg-Booth, was charged with murdering three patients, the attempted murder of another and administering opiates without authority. There were suspicions she might have murdered many more, but the Crown Prosecution Service could not be sure what had killed elderly, very ill patients whose bodies had been cremated.

Ms Grigg-Booth will never stand trial: she was found dead at her home on Monday. Police are not treating the death as suspicious.

Among the recommendations of the Shipman inquiry was that death rates of GPs' patients should be routinely monitored. A team of epidemiologists from Imperial College suggested using statistical quality-control procedures developed during the second world war to detect dud munitions. The rate at which a GP's patients were dying could be monitored to see whether it was going up significantly over time, or varying more than would be expected by chance alone. If so, further investigations would be carried out to find the cause.

If hospitals routinely monitored mortality, would Ms Grigg-Booth have been detected earlier? Unfortunately, it seems unlikely. With less continuity of care and much larger numbers of people in a position to do harm than in general practice, an incompetent or murderous medic would be masked by his colleagues. If there were not to be constant false alarms, the threshold for investigation would have to be set so high that even mass murderers like Shipman might go undetected.

The solution in this case is far more mundane: tighter control of opiates. One of Ms Grigg-Booth's colleagues explained that nurses need a doctor's signature before administering an opiate, but that doctors could be “narky” when paged at night. And so sometimes drugs would be given and signed for later. “I suppose,” said the nurse, “at other times the drug would be administered and never signed off.”

Economist.com WORLD EUROPE

Higher education

University challenges

Sep 1st 2005
From The Economist print edition

The birth pangs of a market in higher education

Get article background

STUDENTS heading to university this autumn will be the last members of a dying system. From 2006, the government will no longer be fixing fees, today roughly £1,200 a year for every course in every English university, regardless of demand, quality or cost to the university. Instead, institutions will be able to set their own fees, up to a maximum of £3,000 a year.

As student numbers have increased, government funding per head has dropped catastrophically. Universities offering expensive courses and small-group tutorials have subsidised their teaching by raiding research and maintenance budgets. Some departments have closed—19 fewer institutions offer physics degrees now than in 1997—and salaries for academics have fallen behind those for other similarly qualified professionals. Realistically, the only way to make ends meet was for students, who are, after all, the main beneficiaries, to pay more.

Labour MPs found a rise in fees hard enough to stomach. But what almost led to Tony Blair's first-ever defeat as prime minister at the hands of his backbenchers was the idea that different universities could charge different fees—which, they feared, would pave the way to elitism. The Higher Education Bill scraped through the House of Commons with a majority of just five in January 2004.

At a casual glance, much of the fuss now seems to have been about nothing. Only three universities will charge less than the maximum, so the principle of variability has not translated into practice. (Bargain-hunters might like to note that, at £2,000 a year, Leeds Metropolitan University will next year be offering the country's cheapest degrees.) In part, this is because the cap is too low—many elite universities say they will still lose money teaching undergraduates. But it is also because universities, reluctant to admit that not all institutions and degrees are of equal value, are afraid of damaging their brands.

So it is encouraging that a few brave institutions are experimenting with pricing and incentives. For example, after this year's exam results were released, the University of Bradford announced that it would be giving £500 scholarships to new computer-science students. The university is looking to fill places through “clearing”, the process whereby students who missed the grades they needed for their preferred courses can apply for vacancies on less popular ones.

But the elite institutions will still be faced with the problem of how to cover the cost of teaching undergraduates. Up till now, the favourite tricks have been to use research money to prop up departmental budgets and to recruit large numbers of overseas students, who can be charged whatever the market will bear. (As a result, the elite universities are taking in ever more of them; Oxford is even planning to cut down on the number of home students to accommodate them.)

The obvious solution—charging more—will still be impossible because of the low cap on fees. The

next most obvious—expanding popular courses where the cost of teaching extra students is low—will also be difficult. Universities are meant to recruit the “right” number of students, in effect, the same number as last year plus or minus 5%. If they recruit too few students they lose money; more surprisingly, the same happens if they recruit too many. Even under the new fee regime, students will be paying less than half the income associated with teaching, with the rest coming from government funding bodies. Not only will a university that overshoots its target numbers lose out on this government funding, but it may also be fined enough to recover the extra students' fees and maintenance grants. This is because the new fees and grants are to be paid up-front by the government and only repaid by students once they are working: in the short term, universities that over-recruit will be stretching the education budget.

It remains to be seen whether these penalties will in fact materialise. The government wants 50% of young people to go into higher education by 2010, a target it looks likely to miss by a mile. As long as overall numbers stay within planned levels, it may well turn a blind eye to universities that decide to increase student numbers taking the most popular courses. Some universities may be tempted to gamble on weaker institutions being unable to fill their places at the new higher prices. Until the cap on fees is raised—which the government has promised won't happen in the lifetime of this parliament—this will be the only way some universities will find teaching worth their while.

Whether or not next year sees top universities testing the possibilities for expansion, those at the budget end of the market are likely to have to cut their fees, offer bribes and hustle for custom. If students facing large debts decide that a so-so course at a so-so university isn't so attractive after all, there may be summer sales, with places going cheap in clearing, or perhaps early-bird discounts for students who make a particular institution their first choice. It's not too much of a stretch to imagine incentives for signing up a friend, or even “buy one, get one half-price” offers for siblings.

It may turn out that capped fees, central control over student numbers and all the paraphernalia designed to allow only a little room for enterprise do not work—that creating a half-market in university teaching is no more manageable than becoming a little bit pregnant.

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Bagehot

The bruiser returns to the ring

Sep 1st 2005
From The Economist print edition

Has enough changed for Ken Clarke finally to be a winner?

Get article background

IT WAS typical Ken Clarke. Declaring himself a candidate for the Tory leadership in an interview with the *Daily Mail*, Mr Clarke claimed to have been “faintly aware” of the rising frenzy of speculation about his intentions last weekend, but that he had been watching the cricket at Trent Bridge, “concentrating rather more on the England attack” against the Australians. What a card. He'd rather see England win the Ashes than become Tory leader. Good old Ken.

That Mr Clarke is a passionate sports fan is beyond doubt; but so is his own certainty that he is uniquely equipped to restore Tory fortunes. With Mr Clarke, what you see is only part of what you get. At 65, behind the banter and the blokeish manner, there is both pride and fierce ambition. However, having been twice previously spurned by his party in favour of callow or incompetent alternatives, Mr Clarke had more or less decided that he would not bother again. As long as predominantly Europhobic party activists had the final say over the leadership, his undisguised enthusiasm for Europe would rule him out.

Two things have changed Mr Clarke's mind about standing again. The first is the expected change in the voting rules, which will restore to the party's MPs the sole right to elect the leader. Despite the unhappiness of some party members, the decision already taken by MPs is likely to be ratified by a wider party body on September 27th. Mr Clarke reckons that the MPs are more likely to swallow their ideological prejudices for the sake of picking someone who might be capable of beating Labour than the activists who view politics as more of a spectator sport.

The second is the fading of Europe as a defining issue both for Mr Clarke and the Tory party. A couple of weeks ago, an interview with Mr Clarke surfaced in *Central Banking*, an obscure, specialist magazine. In it, Mr Clarke described the euro as a “failure” because it had not had the effect expected by him on promoting economic efficiency and improving living standards. He went on to claim that the economic conditions to take Britain into the euro had never been “ideal” and that Britain's monetary policy arrangements (in part, devised by him during his time as chancellor) were superior to those of the European Central Bank. The issue of Britain joining the euro would not arise for more than a decade. In some ways, Mr Clarke was doing no more than state the obvious, but it was still a remarkable reversal from someone who until recently would hear not even a word said against the euro's much-reviled stability and growth pact.

Although a supporter of the European constitution, Mr Clarke was quick to declare it dead after the French and Dutch referendums. But he has now gone further, saying that any moves towards further European institutional integration died with it. There are quite a number of Tory MPs whose obsession with Europe will be satisfied only by Britain quitting the Union, but the majority, though still firmly Eurosceptic, are probably prepared to declare victory and move on. If so, Mr Clarke's recantation may well be enough to lessen, if not entirely remove, the single biggest handicap to his leadership bid.

Two others remain: his age and his deputy chairmanship of British American Tobacco, a firm whose growth partly depends on selling cigarettes to poor countries. With his instinctive lack of political correctness and constant chomping on cheroots, Mr Clarke is at least immunised against any charge of hypocrisy from his lucrative association with the tobacco industry. Does it matter that he would be nearly 70 on entering Downing Street? Apart from the fact that picking two youthful leaders did little for Conservative fortunes, there is something ageless about Mr Clarke with his floppy brown hair, ruddy, unlined features and jaunty tubbiness. Although ten years younger, Gordon Brown, his likely opponent, could almost be a contemporary.

It is one thing to say that Mr Clarke may be electable, another to say that he should be elected. There are strong arguments both for and against Mr Clarke. On the positive side, he is the only authentic political heavyweight left in Conservative politics and he is still by far the most recognisable Tory to voters. His experience of office—education secretary, health secretary, home secretary, chancellor—is matchless. And in dangerous times, experience is something that electorates may demand. As chancellor, he established the economic conditions that enabled New Labour to prosper for so many years. He is a marvellously combative House of Commons performer who would rough up both Tony Blair and Gordon Brown in ways they can barely imagine. He embodies exactly the right combination of toughness and social liberalism. As a prescient critic of Mr Blair's Iraq policy, he would enjoy a freedom of manoeuvre denied to the past two Tory leaders. Above all, Mr Clarke is capable of appealing well beyond the Tory base.

Not as nice as he seems

But there are real doubts too. For all his bumptious bonhomie, in reality Mr Clarke is an unclubbable loner with few political friends: his brother Michael once described him as “very detached emotionally; he is an iceberg—75% under water”. Could he lead a team and inspire loyalty? Mr Clarke is not lazy, as is sometimes alleged, but there is a certain sort of plodding graft that he despises. Would he be prepared to do the patient work needed to rebuild the party's non-existent organisation in Britain's cities outside London? Too often, Mr Clarke gives an impression of intellectual complacency. Does he have the energy and discipline to wrestle with the complex problems of running high-quality yet affordable public services in 2010—20 years after he was health secretary?

With Mr Clarke as Tory leader, politics would be more fun. That would be something. But to win, Mr Clarke must persuade Conservative MPs that he is more than an ageing bruiser.

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Chinese industry and the state

The myth of China Inc

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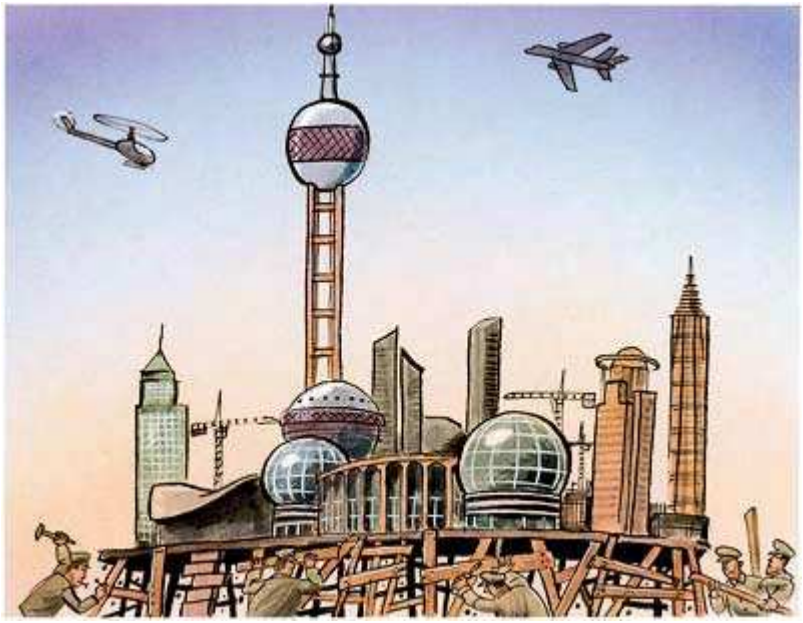

The scare stories—and the chaotic reality

Get article background

AS HU JINTAO, China's president, flies to America this month, commercial ties between the two countries are at a new low. Alongside tensions about China's currency, its growing trade surplus with America and intellectual-property theft, is a new concern: the aggressive international expansion of China's corporations.

In Washington, the $18.5 billion bid by CNOOC, a mainland oil producer, for Unocal, a Californian rival, was portrayed not as a commercial deal, but as a state-funded grab for strategic American assets. It triggered such political opposition that CNOOC abandoned its bid. The FBI has just launched an initiative to expose economic espionage by visiting Chinese students and businessmen. And in Congress, Richard D'Amato, a Democrat and the chairman of the US-China Economic and Security Review Commission, worries aloud that Chinese firms listing shares in America are siphoning American money into a “China bubble”. Nor is concern confined to the United States. India's security bureau is reportedly considering restricting the expansion in India of Huawei, a Chinese telecoms-equipment maker, over its suspected military ties.

The real scaremongers assert that the Chinese state is a single—and single-minded—entity with a master plan to reclaim China's rightful place at the centre of the world. China's companies are thus mere tools of an expansionist policy propagated by Beijing's leadership. More subtle are the fears that, because it is impossible to untangle the ownership of most Chinese companies,

foreigners cannot be sure to whom they are selling. When the ultimate authority could be the Communist state, that is a worry.

The Chinese government certainly wants to create globally competitive firms and it is pushing some to secure strategic resources, like oil and metals, overseas. The Chinese state also still has a broad influence over business. But the chaotic way this power is exercised contributes to the weakness, not the strength, of Chinese firms. “It is not a plausible argument that China Inc can take a co-ordinated Long March overseas,” argues George Gilboy, a research affiliate at the Massachusetts Institute of Technology. “It can't even manage that domestically.”

After two decades of reform and privatisation, only about a third of China's economy is still directly controlled by the government through state-owned enterprises (SOEs). But these are concentrated in key sectors like defence and utilities. While many of the biggest state firms have publicly quoted subsidiaries on international stock markets, the government retains ultimate ownership—one of the objections raised against CNOOC. The top 190 or so SOEs are directly controlled by the State Assets Supervision and Administration Commission (SASAC)—set up in 2003 to restructure these often moribund firms.

And yet even this group of elite companies is not guided by a single, controlling hand. Take telecoms: China's early decision to deregulate the sector and break up the state monopoly into four competing firms—two fixed-line (China Telecom and China Netcom) and two mobile (China Mobile and China Unicom)—was widely admired. It made China the world's largest telecoms market and created fat profits for operators. Yet Beijing's bureaucrats now threaten to undo this good work. Frightened by the growth of new services and a price war, they recently forced the bosses of the four firms to take each other's jobs to discourage competition, to the amazement of some independent directors.

Infighting among bureaucracies with competing agendas crops up again and again across China's industrial landscape. It made life so difficult in the power industry, that some foreign investors quit in disgust, causing power shortages. Overseas investors have been equally befuddled in the media sector, where joint-ventures promised over the past two years are suddenly off the agenda. The media regulator, SARFT, which also oversees cable television operators, is battling MII, the telecoms regulator, to prevent the big telecoms operators from launching competing internet TV services. That SARFT happens to be the last of four stamps of approval needed to obtain a licence could cripple the industry before it is born.

Battles between competing branches of central government are overlaid by struggles between central government and local officials, who want to protect jobs in their own backyard. In a country with a saying “the hills are high and the emperor is far away”, edicts from Beijing are routinely ignored.

The contrast with Japan is stark. The Japanese government had less direct control over its corporations, but its officials co-ordinated their domestic development before earmarking sectors for overseas expansion. The Chinese bureaucracy, while in direct charge of more of the national economy, is riven by factional infighting.

Unhappily, the resulting chaos is also hurting the most promising two-thirds of the economy that is in private hands. Private companies are often beholden to state banks for capital and to local officials for favours and contracts. Since private enterprise was not even acknowledged until 1988, entrepreneurs had to bring state investors aboard as political protection, becoming so-called “red-hat” companies. Yasheng Huang, a professor at MIT, says that the results can be disastrous: “Government shareholders may be passive at first, but once a company succeeds, they interfere. Countless Chinese firms have been driven to bankruptcy or failed to grow big because local governments decided to exercise their legal claims on ownership.”

Take Kelon, a refrigerator maker. Currently on the brink of collapse after an embezzlement scandal, it once was China's best firm. With the help of its tiny township government in Shunde county, its founders, Pan Ning and Wang Guoduan, turned it from the 42nd-largest fridge maker in 1984 into China's biggest in six years. Focused management and marketing flair (Chinese people put fridges in the living room to impress visitors, so Kelon made the smartest models) led to a Hong Kong listing and global awards. However, in the late 1990s, Guangdong's provincial government forced Kelon to take over a loss-making SOE air-conditioner maker at an exorbitant price. Because Mr Pan and Mr Wang had not shifted ownership to Hong Kong, Guangdong officials could force the Shunde shareholders to fire them and appoint a bureaucrat to replace them. He then rapidly ruined the company.

Now, worryingly, something similar may threaten Haier, China's leading white-goods maker, which recently failed with a bid for Maytag, an American rival. Admired globally for its efficiency and innovation, Qingdao-based Haier is the creation of Zhang Ruimin, China's most famous entrepreneur, who transformed a company so demotivated that its workers used to urinate on the factory floor. Yet Mr Zhang has just lost a long fight to reward his managers with shares via a Hong Kong listing. Late last year SASAC ruled that Haier was owned by the Qingdao government and that management buy-outs at big SOEs were forbidden. Compare that with Legend (now Lenovo), which bought IBM's computer business—it escaped state influence and has flourished. A “red-hat” company, it was originally banned from selling personal computers in China, so went to Hong Kong to export, set up a joint venture and obtained a Hong Kong listing. Although it returned to China to manufacture, its production and research facilities are registered as Hong Kong affiliates, not with Legend China, and it is reducing the share owned by its state sponsor. Mr Huang of MIT argues, “there is nothing domestic about Legend except the nationality of its managers. It is as foreign in China as GE.”

Reasons to be fearful

Foreign fears about the expansion of Chinese firms are often compounded by the murkiness of their ownership. Take Huawei, a telecoms firm that is the most global of any Chinese company, and also among the least transparent. Although technically private, its shares are probably owned by local state telecoms customers. It also has a $10 billion credit line from China Development Bank, famed for its loans to support state policy. Its founder, Ren Zhengfei, was a former People's Liberation Army officer. But the fact that no one knows who runs Huawei could weaken it. It has grown fast in a booming market, but its unclear ownership means it cannot easily get a stockmarket listing, nor reward staff with stock options. It may also hinder plans for overseas expansion—like a rumoured bid for Britain's Marconi—since potential foreign partners will be wary of a firm with such an opaque ownership structure.

Fears that Chinese firms are acting as the commercial arm of an expansionist state are thus belied by a more complicated and disorderly reality. The real reason to fear China's overseas expansion is quite different. Because Chinese firms have grown up in an irrational and chaotic business environment, they may export some very bad habits. As Mr Gilboy puts it: “when Japanese companies took over American ones, they mostly made them better. If the Chinese run foreign firms like they operate at home, driving prices down, misallocating capital and over-diversifying, that is genuinely something to fear.”

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Petrol distribution

Tanked up

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Selling off Italy's petrol stations

MANY tourists driving across Europe this summer have got that sinking feeling at some point: they are on a foreign motorway, and the petrol gauge warning light has lit up. It is never a good moment. But if it has to happen, it is perhaps best to be in Italy.

Italy has almost 22,500 petrol stations. By comparison, according to figures from the Italian industry association, Germany has 15,400, France 14,200 and Britain just 10,500. But the flip side of big numbers is small amounts of business. Around 1.6m litres are sold at a typical Italian petrol station each year, compared with just over 3m litres in Germany and France, and more than 3.5m litres in Britain. No wonder Italy's government and oil firms keep talking about rationalisation.

ENI, the market leader with its ubiquitous Agip brand, is trying, up to a point. ENI's 7,200 petrol stations accounted for 36% of Italian retail fuel sales last year. It aims to trim this to 4,270 outlets by 2008. But last year its net closures amounted to just 46 petrol stations. And it will achieve this goal only by selling the network of petrol stations associated with its lesser Italiana Petroli brand, a deal approved this week by Italy's competition authorities.

Italian petrol retailing clearly needs to modernise and the antitrust authorities believe that supermarkets should play a bigger role in the business, as they do elsewhere. (In Britain, Tesco now accounts for 11% of petrol sales.) But newcomers such as the supermarkets face high barriers to entry. Strict regulations generally prevent petrol stations selling anything other than fuel. Away from motorways, opening hours are rigidly limited. Foreigners looking for petrol may find that Italy, long on service stations, is short on service.

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Economist.com BUSINESS

The satellite industry

Coming together

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A big merger in the satellite industry is rich with irony

"TRUTH and technology will triumph over bullshit and bureaucracy." That was the motto of Rene Anselmo, the maverick founder of PanAmSat, who set out in 1984 to overthrow the monopoly over the satellite business then held by Intelsat, an international consortium backed by over 100 governments and incumbent telecoms operators. Anselmo took on the slow-moving, bureaucratic industry with the aid of Spot, a cartoon dog who was depicted urinating on the leg of anyone who stood in his way. Both motto and mascot can still be seen on PanAmSat's website, but probably not for much longer. On August 29th Intelsat, now a private firm and the industry's second-largest operator, announced that it had agreed to buy PanAmSat for $3.2 billion. Combining its 28 satellites with PanAmSat's 25 will put Intelsat back on top of the industry. Anselmo, who died in 1995, "will be spinning in his grave," says Simon Bull of Comsys, a satellite consultancy.

But has Anselmo had the last laugh? Intelsat's chief executive, David McGlade, boasted that "the two companies are complementary in customer, geographic and product focus." That is true: Intelsat's satellites mainly provide telephony and data services outside America, while PanAmSat mainly provides video services within America. Demand for data services has grown lately, particularly since the American government, which leases 3-4% of global satellite capacity, is relying heavily on satellite links to support its operations in Afghanistan and Iraq. But telephony, which used to be Intelsat's core business, has been in decline for years, thanks to the rise of cheaper fibre-optic links.

Carrying video, by contrast, is far more lucrative: video now accounts for 61% of leased satellite capacity and 67% of revenue, says Patrick French, an analyst at Northern Sky Research. Demand for video capacity over North America is expected to grow, particularly as new high-definition television services start to take off. PanAmSat, which pioneered the use of satellites to distribute video under Anselmo, therefore looks very attractive to Intelsat. "They know their core business is going away, and they need to move into video," says Mr French. Intelsat has made a few smaller acquisitions to this end, such as the purchase of Loral's North American satellites in 2003.

Will the deal prompt further consolidation? With dozens of tiny firms and a handful of giants, there would seem to be plenty of scope for it. But many of the small players serve local niches, says Rachel Villain of Euroconsult, or are government-backed vanity projects that are not for sale for political reasons. Of course, private-equity investors, who have piled into the satellite industry, would certainly like to see more big deals: those who bought PanAmSat last year now stand to walk away with $2.35 billion, provided the sale to Intelsat is approved by regulators.

Those in the industry, meanwhile, are pondering another question: will the merged firm remain hobbled by Intelsat's legendary bureaucracy—embodied by its labyrinthine headquarters in Washington, DC? The worry is that the bureaucrats could yet triumph after all.

Economist.com BUSINESS

Martha Stewart

Better than Google

Sep 1st 2005 | NEW YORK
From The Economist print edition

Why investors love Martha

AP

Something new to smile about

HARD as jail must have been for Martha Stewart, an American celebrity revered for her advice on cooking and housekeeping, from a strictly financial point of view it was great while it lasted. Between July 16th last year, when she was given a five-month sentence for obstructing justice, and March 4th, when she left prison under house arrest, the value of her publicly listed publishing and merchandising company, Martha Stewart Living Omnimedia (MSO), almost tripled. The shares fell sharply when she left jail but have recovered somewhat since (see chart).

Nothing much changed at MSO to explain the surge, save that investors decided they had overestimated Ms Stewart's legal troubles and that things would rebound after her brief absence. Now they will find out if they were right. Ms Stewart ended her house-arrest this week, kicked off her electronic ankle-bracelet, and resumed a more or less normal life subject to another 18 months' probation. She resigned from the board of MSO last year, but holds almost 60% of the shares.

She also accounts, arguably, for almost 90% of the company's market value. Only her perceived earning power explains the difference between MSO's $1.6 billion market capitalisation this week, and the $167m of shareholders' equity on its June balance sheet.

The early signs are that Ms Stewart's value has been holding up well. MSO says that advertising pages are 35% higher year-on-year at its flagship magazine, *Martha Stewart Living*, after slumping during the legal troubles. This month Ms Stewart re-starts her daytime television show; and joins Donald Trump as the star of a “reality” show called “The Apprentice”. Soon she will launch a digital radio channel and two new books.

It helps that her crime is seen widely as a minor one. She was not convicted of any wrongdoing at her own company, but of lying about a private sale of shares in a biotech company. Her jail time has won her new fans by tempering a past image of perfectionism which some critics found irritating.

Turning popularity into profits is another matter. Michael Meltz, an analyst at Bear Stearns, thinks MSO may earn about $10m next year, after three years of losses. That still means the company is valued at 160 times prospective earnings, or roughly four times the rating of Google. Ms Stewart is good at what she does, but whether she is that good is another question—and, even if she is, at 64, she will not be doing it for ever.

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Economist.com BUSINESS

Mergers and acquisitions

Europe's nascent merger boom

Sep 1st 2005 | PARIS
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European mergers are booming, but economic nationalism remains an obstacle

La grande nation

European cross-border merger & acquisition activity
Jan 1st-Aug 15th 2005

Country of acquirer	Deal value $bn	Number of deals
France	59.5	146
United States	55.6	398
Italy	27.9	76
Britain	19.8	272
Spain	18.0	53
Sweden	15.7	136
Switzerland	11.7	70
Germany	7.4	164
Denmark	6.6	91
Saudi Arabia	6.6	2
Total	286.6	2,251

Source: Dealogic

Get article background

WHEN is a cross-border takeover in Europe a good thing? For the French government, the answer seems to be clear. It is to be applauded when the company doing the buying hails from France, but treated with deep suspicion when the target is French. Spooked by rumours that Danone, a food company that owns much-loved French brands, might be taken over by America's PepsiCo, the government has announced its intention to come up with a list of strategic French industries that will be protected from foreign takeover. “Our policy is not to oppose by principle every acquisition of a French company,” says François Loos, minister for industry. But if yoghurt is a strategic industry, Mr Loos's promised list may be quite long.

While French politicians contemplate an industrial Maginot line, French businessmen are snapping up companies elsewhere in Europe. According to Dealogic, a research firm, French firms spent almost $60 billion on foreign takeovers in Europe alone in the first seven months of this year (see table). Pernod Ricard, a drinks company, bought its British rival Allied Domecq; Suez, a utilities company, bought Electrabel of Belgium; France Telecom took over Spain's Amena, a mobile-phone operator. Just this week, another French firm, Saint-Gobain, a building-materials company, had a £3.6 billion ($6.5 billion) hostile bid for Britain's BPB rejected.

“We are in the early stages of a new merger cycle,” says Jeffrey Rosen of Lazard, an investment

bank. Deal activity in all major European markets is up by about 50%. There is great potential for value-creating deals within the EU, as fragmented national economies merge into a real single market. But there are big obstacles too. As France shows, many politicians cling to the idea of “national champions” and create obstacles to cross-border mergers.

Still, there are powerful forces pushing in the opposite direction. Strong corporate profits are driving the current increase in mergers and acquisitions (M&A). After atoning for the past merger wave's excesses with cost cuts and sales of unrelated businesses, many big companies have healthy balance sheets. Credit is cheap, and shareholders are keen on takeovers once again. France Telecom shares jumped after the announcement of its acquisition of Amena, as did those of Pernod Ricard and Suez after their respective takeovers were made public.

Company bosses are more cheerful too, according to recent opinion surveys. This may reflect a belated uptick in the EU's economic performance. The European Commission forecasts the economy will expand by around 0.4% and 0.6% in the third and fourth quarters respectively—the fastest growth since the first half of 2004, though much depends on oil prices.

At present, European mergers represent about one-third of global deals while American deals account for half. Europe's share is set to grow, but only if politicians resist their instinct to meddle with international mergers, which represent more than half the total. Banking and utilities, for instance, remain largely national industries in Europe, because they are considered “strategic”. Cross-border takeovers in these sectors are intensely political. The French and Italian governments squabbled for more than a year about whether to allow Electricité de France (EDF) to buy Edison, an Italian power company. Antonio Fazio, the governor of the Bank of Italy, spent months this year employing unusual methods (with the tacit approval of the government) to block a Spanish and a Dutch bid for two of the country's mid-sized banks.

But European politicians' interference is not yet egregious enough to discourage the British and American private-equity firms that are becoming an increasing presence in the euro zone. About one-fifth to one-third of current European merger activity is generated by private-equity firms. These firms manage funds that take controlling stakes in what they think are undervalued and badly managed companies. On August 22nd Permira, a firm based in London, and Kohlberg Kravis Roberts, a New York firm, took over SBS Broadcasting, a pan-European broadcaster. Several private-equity companies are rumoured to be eyeing bits of Boots, a British chemist.

The rise of private equity should be good news for corporate Europe. Such firms specialise in buying and fixing companies that few want and provide liquidity to the market, says Gordon Dyal of Goldman Sachs. They can also sharpen up business performance, by snapping up neglected bits of conglomerates and running them as independent businesses. There is obvious scope for this in Europe, where the degree of conglomeration is still far higher than in America.

Any high-profile move by an “Anglo-Saxon” private-equity firm in continental Europe is sure to be controversial. But even so, under current European law, national governments can do very little to block bids for private companies. EU officials have been quick to point out that, if France genuinely tries to protect a range of “strategic” industries from takeover, even by firms from within the European Union, it would be in “flagrant” breach of EU law on the free movement of capital. Those regulations are indeed soon to get a boost, with the passage of a new takeover directive, which must be law in all EU states by May 2006.

This could be the best year for European M&A since the internet-bubble years of the late 1990s. If there were another mega deal such as last year's €55 billion ($65 billion) merger of Sanofi-Synthélabo and Aventis, two French pharmaceutical firms, mergers could cross the $1 trillion threshold for the first time since 2000. But if the deal is a cross-border merger, and the target is French, stand by for fireworks.

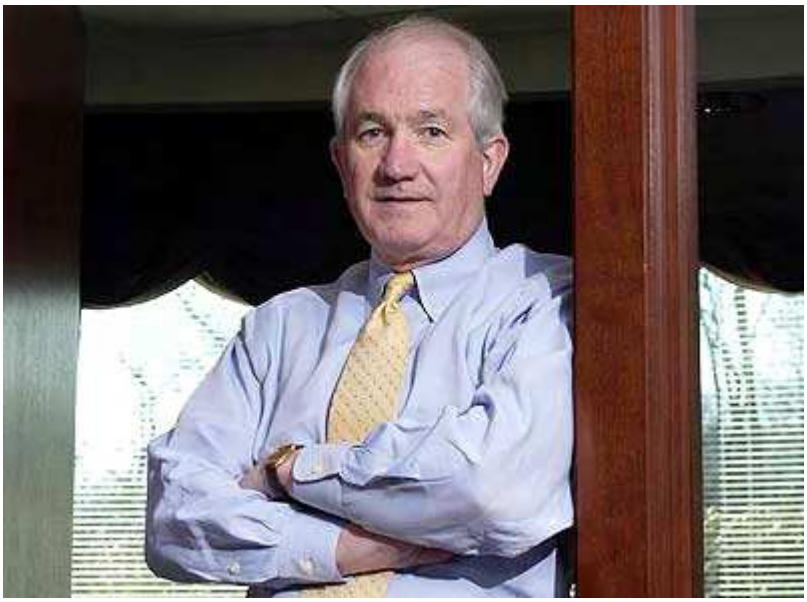
Economist.com BUSINESS

Face value

The prophet of prison

Sep 1st 2005
From The Economist print edition

CCA



Is John Ferguson the saviour of America's prison system or its destroyer?

JOHN FERGUSON has done time in prison. He well remembers the days he spent guarding inmates and mopping floors at a women's jail in New Mexico. Four years ago, he swapped his office for the prison floor to take part in a television series that sent corporate executives to work on the front-lines of their companies. The experience was educational: “Your feet got tired because you're walking around on concrete all the time,” he says, with his slight Tennessee twang. “I learned that it's a business that could be very mundane but you can't ever relax—you've got some folks that are spending every working hour trying to figure out how to do mischief”.

As head of America's largest private prison operator, the Nashville-based Corrections Corp of America (CCA), Mr Ferguson is responsible for 63,000 inmates in 19 states and Washington, DC—and his potential market is growing all the time. Inmate numbers in America rose by 25% between 1996 and 2004. America now has 726 prison inmates for every 100,000 people, compared with 142 in England, 91 in France and 58 in Japan. With public prisons notoriously overstretched, private prisons have been quietly picking up the slack since the Reagan years.

It is a business prone to nasty surprises. CCA, which had confidently built prisons during the 1990s boom years, was saddled with debt and empty beds after stabbings and escapes at one of its Ohio prisons caused a slump in business. Mr Ferguson took the reins in 2000 and salvaged the firm, but there have still been plenty of bumps. In the past year CCA has weathered riots in Oklahoma (one death) and Kentucky as well as a hostage-taking in Florida—to say nothing of lawsuits following a riot in Colorado in July 2004. “Inmates are litigious,” laments Mr Ferguson.

All these problems also afflict state-run prisons. But they are a particular threat to CCA, because many people still find the very idea of a privately run prison faintly immoral. Critics complain that a private company will inevitably treat prisoners simply as inventory. But Mr Ferguson responds that prisons—like any other public service—can be improved by competition and flexibility. For states with a sudden capacity problem, CCA can supply “just-in-time” beds. The company can also build prisons faster than the government—15 months for CCA compared with up to five years for states and eight for the federal government.

The private sector can offer other innovations. After his spell on the front-line in New Mexico, Mr Ferguson came away appalled by the number of hours prison guards spend documenting their movements in a logbook; he is trying to switch to an electronic system. But his real trump card is cost. CCA and its competitors can almost always undercut the state—Florida even obliges the private sector to operate 7% more cheaply than the public sector. The savings owe much to lower staffing costs, and economies of scale. “The public sector has a tendency not to eliminate positions when they're not needed,” says Mr Ferguson, who spent four years as Tennessee's finance commissioner.

Only a handful of CCA facilities has unions, which gives the company a cost advantage since the public-sector prisons tend to have powerful unions. Critics of private prisons say that the CCA method poses a security risk, since workers with fewer benefits and lower pay will be less vigilant. But Mr Ferguson has a ready retort: “If that is the case, Southwest Airlines would be having a crash every month,” he says, pointing out that his prisons are all regulated and inspected by the government.

If Mr Ferguson can see off his critics, there is plenty of scope for growth. Although CCA's latest quarterly earnings showed no advance from the same period last year—the result of a regrettable shortage of inmates at some facilities—Mr Ferguson expects big new contracts with the Federal Bureau of Prisons. The bureau is already CCA's largest customer, and its projections put it about 30,000 beds short by 2010, according to CCA. Many of the detainees sent to private prisons are illegal immigrants; indeed, a surge in criminal aliens needing beds helped save CCA five years ago. Immigration and Customs Enforcement, another federal bureau, could bring more business if Congress funds the intelligence-reform bill passed last in late 2004.

Mr Ferguson rules out going abroad for new business—one of his first acts upon taking charge five years ago was to ditch CCA's international ventures. A much more promising source of potential business is state governments. Private prisons have footholds in about three-quarters of the 50 states. They are strongest in the South and west—but northern states are beginning to open up as well. Vermont, for example, last year asked CCA to house 700 of its inmates, mostly in a Kentucky facility.

Golden opportunities

The big prize would be California. So far the Golden State has mostly run its own prisons. But the badly overcrowded public system has huge problems—a federal judge recently mandated reforms to the provision of health care for Californian inmates, after denouncing instances of “outright depravity”. Private operators are closely watching Governor Arnold Schwarzenegger's prison policies and union-busting activities. CCA has no contracts yet in California, although in July the GEO Group, CCA's largest rival, was contracted to operate a 200-bed minimum-security facility in California.

Privatisation of existing prisons gives plenty of scope for CCA to expand, without any further increase in the United States' already exceptional level of incarceration. Mr Ferguson fends off suggestions that he longs for a further surge in prisoner numbers, or lobbies for more lock-em-up

laws. “It's kind of like saying a heart surgeon's out advocating to reduce anti-smoking programs so they'll have more hearts to work on—we just don't do that.” In any case, the trend towards locking up felons for ever longer periods is already firmly established.

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Economist.com BUSINESS

The digital home

Science fiction?

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From The Economist print edition

Technology firms are pushing a futuristic vision of home entertainment not because consumers are desperate for it but because they themselves are

RECENTLY, at one of the fast-proliferating conferences devoted to the “digital home”, John Burke, an executive at Motorola, a maker of mobile phones and digital gadgets, showed a video that presented his company's version of this vision. In the clip, a youngish man wakes up to a rock video that automatically starts playing on a screen next to his bed. He gets up to have breakfast and the rock video follows him to a screen in the kitchen. He moves into the living room and up pops the rock video on yet another screen. When he leaves his flat and gets into his car, the video starts playing on a screen in the steering wheel.

To ordinary humans this sort of thing must seem like silly—or downright frightening—marketing claptrap. In fact, even Mr Burke's audience of self-selected technophiles seemed sceptical. “Did you notice that the guy was a bachelor,” said Tim Dowling, the boss of Pure Networks, a software firm in Seattle that helps users to set up and troubleshoot home-computer networks. “That alone tells you that they're out of touch. I thought: How dumb.” Real people do not want to be hounded through their home and their life by some video stream, he argues; they just want help with basic headaches, such as getting the kids' laptop, mom's Apple Macintosh and dad's Windows machine to share the family's printer.

Whether or not computer, software, consumer-electronics, telecoms, cable and internet companies are in fact out of touch with consumers may be the biggest question facing these industries today. That is because the “digital home”, a concept and category hugely hyped in executive circles but still rarely heard in discussions among consumers, represents their greatest hope for revenue growth. Demand from corporate buyers of technology has barely recovered from the dotcom bust and is widely expected to be unimpressive for years. By contrast, the homes of consumers appear to technology vendors as a barely tamed analogue wilderness. Darcy Travlos, an analyst at CreditSights, a research firm, estimates the market opportunity of the digital home at $250 billion

in America alone and $1 trillion worldwide in three to seven years.

“We view the digital home as critically important,” says Craig Mundie, one of three chief technology officers at Microsoft, the world's largest software company. “The home is much more exciting than the workplace.” Computers have already led to small revolutions in boosting productivity in the office and helping people to communicate and to be creative, he says, so “we're pretty confident” that computers will have a similar effect on the way people consume entertainment. Intel, the world's largest semiconductor maker, recently reorganised itself into new business divisions including, prominently, one called “digital home”. Last week it formally launched Viiv, a bundle of chips intended for use in digital-home PCs. Consumer-electronics firms such as Sony, computer-makers such as Hewlett-Packard (HP) and Apple, telecoms giants such as Verizon or SBC, cable companies such as Comcast, internet firms such as Yahoo!, networking-equipment companies such as Cisco—all agree that the digital home is where the action will be and are investing furiously to make sure they have a good chance of playing a leading role.

Their first challenge in stimulating any sort of consumer interest is the difficulty of merely explaining what the digital home is supposed to be. You might think, for instance, that the term refers to the long-established trend away from analogue and towards digital media. In music, most people have completed their migration from vinyl records and tapes to digital CDs. In films, the trend from videotapes to DVDs is not far behind. In photography, traditional film is fast being replaced by digital cameras and pictures. TV and radio broadcasters are also shifting to digital transmissions, with Britain leading the way.

Confusingly, however, that is not what vendors mean when they talk about the digital home. Instead, they invariably mean a home in which all sorts of electronic devices—from the personal computer (PC) to the TV set-top box, the stereo, the game console and, in some versions, even the garage door and refrigerator—are connected, both to one another and to the internet. Hence the Motorola marketing video that Mr Burke was showing. Its purpose was to illustrate what Motorola, like Microsoft, calls “seamlessness”, as digital content hops automatically between various devices and screens. The excitement, therefore, is not so much about content being digital, but about its delivery switching from physical things (such as CDs) to photons (such as wireless downloads or streaming), because this requires consumers to buy new gadgets.

Believers in this future point to encouraging statistics. Parks Associates, a research firm in Texas that specialises in the digital home (and which organised the conference at which Mr Burke gave his keynote address) surveyed a group of internet users and found that 84% of them use their PCs to store digital photos, 59% to store music, 36% for video clips and 26% for personal videos. If one includes devices other than PCs—such as TiVo, a popular digital video recorder—17% also store movies and TV shows. In theory, these people could soon avail themselves of new wireless-networking technologies, such as an emerging standard called “ultrawideband”, to pipe all this content from their collections to electronic picture frames, screens and portable devices.

Joined-up thinking

That is not at all what they want to do today, however. Another study by Parks Associates found that 89% of people with a home-computer network felt that the relatively modest goal of sharing internet access is its most important function, with printer-sharing the second priority. Worse, 27% of people who bought network gear said that they ran into problems during configuration, leading many to call the help desk of their internet service provider (who may or may not be responsible for the problem) at an estimated annual cost of $1.4 billion to that industry. Even downloading entertainment, as opposed to buying it on discs, appears over-hyped. According to a study by the OECD, there were over 230 websites offering 1m tracks in America and Europe at the end of 2004. But these online sales accounted for less than 2% of total music revenues; even with

fast growth, they are projected to rise only by 5-10% by 2008.

All this points to a huge problem with the digital-home vision: the lack, among most consumers, of any sense of crisis about the status quo in entertainment. “We don't think many folks are looking for an electronic nerve centre in their homes,” says Pip Coburn, who runs Coburn Ventures, a technology-consulting and investment firm. After all, popping in a DVD, say, is so easy and works so well. By contrast, getting a digital home up and running promises several lost weekends of fiddling with manuals and settings, and hefty expenses in new gear. According to Mr Coburn's formula for evaluating new technologies, whereby adoption is a function of the users' sense of crisis (ie, motivation to change) outweighing their perceived pain of switching, the digital home ranks as a clear “loser”.

This miscalculation—if that is what it is—by the large vendors stems from their history of catering to companies rather than people, says Pure Networks' Mr Dowling (who used to be at Intel and who hired some 40 of his 60 employees from Microsoft). During the information-technology boom, the industry sold its wares mostly to chief information officers or chief technology officers with big budgets. These are customers who tend to be receptive toward buying “solutions” rather than products, and often hire consultants such as IBM Global Services to pull together hardware and software from various vendors. But “consumers don't buy as an IT manager does,” says Mr Dowling. “They buy spur-of-the-moment and hodge podge; they buy things, not systems.” To the extent that the digital home is not a thing but a solution, he thinks, “the vendors are all fooling themselves.”

The vendors, naturally, disagree vehemently. “When you ask customers what they want, they will never tell you. You have to show them first,” says Microsoft's Mr Mundie. That is why Microsoft has, since 1994, had an impressive (or, to some people, intimidating) mock digital home on its campus in Redmond, Washington State, which it updates with the latest gadgets. Intel, NETGEAR, HP and most other self-respecting technology firms have similar mock-ups for display. There is, argues Motorola's Mr Burke, a huge “need to educate consumers about the value of a connected home and lifestyle.”

Talking the same language

Outside the controlled environment of a mock home or conference demonstration, however, educating consumers tends to backfire. That is because real-world digital homes usually do not work very well. The premise of the entire vision, remember, is that heterogeneous devices talk to one another and readily transfer content to wherever the consumer wants to access it. This requires compatibility—“interoperability” in the jargon—among vendors involved in two technological categories.

The first is file formats and codecs (short for coder-decoders), which encode digital information—such as a picture, song or film—compress it for transmission and storage, and decompress it again for viewing and listening. The second is digital-rights management software, or DRM, which protects such content against piracy and unauthorised copying. DRM allows the copyright holders of content—film studios and record companies, in essence—to define such parameters as when a film or song that is downloaded “expires”, or how many times it can be copied to another device, such as a portable player.

The trouble starts here, with a bewildering list of acronyms that no ordinary consumer should ever have to know, but currently needs to know, to set up a digital home. The Moving Picture Experts Group (MPEG) is an industry body that defines widely used codecs such as MPEG-2 for video and MP3 for audio. But the big vendors prefer their own codecs—Microsoft its WM9 (short for Windows-Media-9), Apple, the market leader in online music sales, its AAC, and so on.

In DRM, the situation is even more chaotic. Microsoft pushes its Windows DRM; RealNetworks, which makes rival media software, has Helix; Sony has OpenMG; Apple likes FairPlay, and so on. The upshot is that consumers cannot mix online services, gadgets and software from different vendors and be sure that the content they have paid for actually works. Music bought online from Microsoft's MSN or Yahoo!, for instance, does not work on Apple's iTunes or iPod, and vice versa.

This challenge is daunting because DRM technologies should not only be compatible today, but for all eternity. Otherwise, consumers will be afraid to pay for content, and will stick with CDs and DVDs, which seem painless and safe by comparison. “If consumers even know there's a DRM, what it is, and how it works, we've already failed,” says Peter Lee, an executive at Disney. The same goes for codecs. “The user shouldn't know or care what format they're using,” says James Poder, an engineer at Comcast, America's largest cable company and broadband internet service provider, because “consumers don't want to be IT administrators for their own home.”

Prisoner's dilemma

It may seem ironic, therefore, that vendors are refusing to make their technologies interoperable, thus potentially killing their own vision. On the other hand, it makes sense for each to try to make its own proprietary technology the winner, in order later to grab a disproportionate share of the market. The starting point of cable and telecoms companies, for instance, is as providers of broadband pipes into the home. So they are investing in IPTV (internet-protocol television), a vision in which content resides on the network and is pulled into the home on demand. Thus, says Cyrus Mewawalla, an analyst at Westhall Capital, a broker in London, America's Verizon and SBC and others are investing hugely in laying fibre-optic cables to homes (at a cost of about $1,000 per household), hoping that IPTV and the necessary set-top box could “evolve into the primary gateway to the digital home.” By controlling this gateway, they could offer a bundle of telephony, internet and entertainment, in effect “owning” the customer.

This would at the same time help them to parry their biggest threat: Microsoft. Microsoft has itself invested in IPTV, ostensibly in partnership with telecoms and cable companies. Like its loss-making investment in game consoles (called Xbox), however, Microsoft intends this as a purely defensive hedge, says Matt Rosoff, an analyst at Directions on Microsoft, an independent research outfit near Seattle. Instead, thinks Mr Rosoff, Microsoft's strategy is to establish the Windows-run PC as the uncontested hub of the digital home. Hence its all-out push to establish its codecs and DRM as the standard. This would allow Microsoft to keep selling Windows upgrades and to earn royalties from hardware and from consumer-electronics companies that make “spokes” for the Windows hub, such as portable music and video players, screens and online services.

Microsoft's most explicit attempt so far is a version of its current operating system called Windows Media Centre Edition (MCE), which puts a simplified menu on top of the desktop screen for use with a remote control from the sofa. The MCE was first launched in October 2002, and has been upgraded several times since, but it has so far been mostly a dud, running fewer than 1% of all PCs sold last year. Microsoft now hopes to make MCE more relevant by selling “extenders”, little devices that can hook on to a TV set or stereo and communicate with the PC over a wireless network. Its biggest hope, however, is for Vista (previously known by the code name of Longhorn), the next version of Windows, which is due to be released late next year (after several delays).

According to Microsoft's Mr Mundie, there is no question that the Windows PC will win this fight to become the central repository for all digital content, for a simple reason. The cable and telecoms companies, he says, are hampered by their business model, in which the set-top boxes sit on their own balance sheet and are leased, at subsidised rates, to consumers. This means that their incentive will always be to make the boxes cheaper. By contrast, Microsoft's incentive is to make

its operating system more sophisticated, in everything from parental controls to usability. By the same logic, Microsoft will beat the consumer-electronics companies (such as Sony and Samsung). Their business model relies on selling devices rather than on recurring licence revenues. This leads to clutter in the home, without organisation of the content.

Tom Berquist, an industry analyst at Citigroup, broadly agrees that the PC is likely to win. The on-demand world on offer from, say, Comcast, is simply not portable enough, he thinks. By contrast, he says, moving content to PCs potentially “liberates you from proprietary technology and lets you use content on any device.” In this sense, the only real competition to Microsoft is Apple, whose Macintosh operating system is widely considered to be more elegant and user-friendly than Windows, and which has a considerable headstart with the huge popularity of its iTunes music service and iPod player.

Apple's problem, however, is that it has only 2.6% of the world market for PCs, whereas Windows runs on almost all the rest. Apple also differs from Microsoft in that it simultaneously wants to be the main portable-device maker. It is, in other words, a software, hardware and consumer-electronics company all at once, and that does not leave much room for alliances with other industries to manufacture spokes for an Apple hub. There are signs that Apple is becoming more agnostic in order to compete with Microsoft. It has a deal with HP, traditionally a Microsoft ally (HP was, for instance, the first computer maker to ship Windows Media Centre Edition), under which HP bundles Apple's iTunes software on to PCs running Microsoft Windows. In a surprising announcement in June, Apple also said that it would start using microprocessors from Intel, another traditional Microsoft ally.

Winner takes all?

For the foreseeable future, the only certainty is that all these mighty companies will continue to preach interoperability while pursuing proprietary hegemony. This could lead to several scenarios. One is that one company, or camp, wins. The digital home, unified by the winner's standards, might then become a reality in the mass market. For this to happen, however, several companies and industries would first have to make huge strategic mistakes, and consumers would have to accede, in effect, to a repeat of the “Wintel” (Windows and Intel) near monopoly in the PC industry today.

Another possibility is that the technology wars end with a truce, perhaps brokered by industry consortia that push open standards. This would be infinitely preferable for consumers and would probably make the digital home a reality much sooner, since it would mean that consumers could shop incrementally for new gadgets, all of which will fit with the others. The catch for providers is that this is much less exciting for their own bottom lines.

There is a third possibility. This is that the wars continue, but consumers continue not to care. As John Barrett, research director at Parks Associates, says, “it seems that we've concocted a new variant of the ‘paperless' office.” This, you recall, was the consensus a decade or so ago among technophiles (but almost nobody else), that computer technology would save our forests by freeing us from having to read and write on paper. Today's variant, says Mr Barrett, is “no more tapes, CDs, DVDs, discs.” In other words, expect them to be around for a very long time to come.

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Economist.com FINANCE & ECONOMICS

Monetary policy

Alan Greenspan changes key

Sep 1st 2005 | JACKSON HOLE
From The Economist print edition

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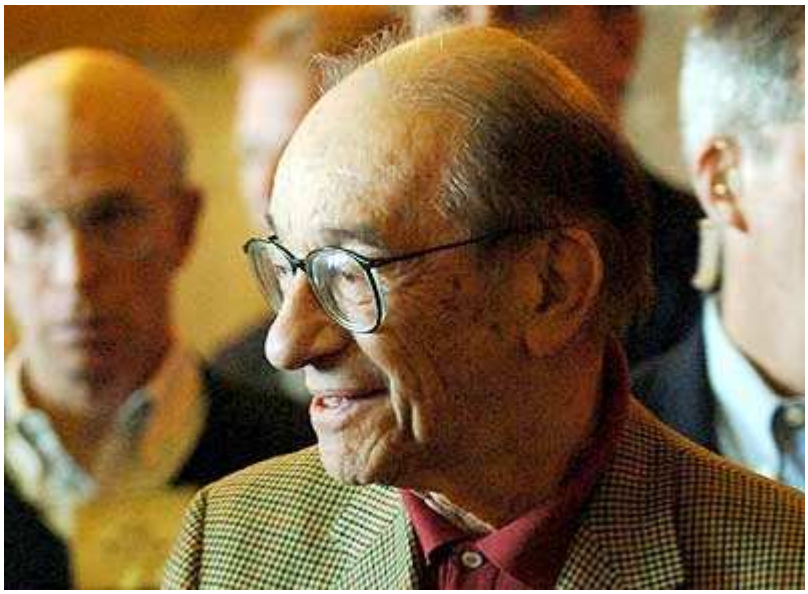


As economists try to assess the "Greenspan legacy", the maestro himself seems to be altering his tune

THE annual symposium of the Federal Reserve Bank of Kansas City is one of the highlights of the international economic calendar—and not just because it is held in Jackson Hole, Wyoming, at the foot of the majestic Tetons. At this year's meeting, a collection of central bankers and economists, distinguished even by the elevated standards of Jackson Hole, paid tribute to Alan Greenspan's 18 years as chairman of the Federal Reserve. His term ends on January 31st.

Usually the air is pretty thin at 6,000 feet. This time, it was thick with praise for Mr Greenspan. The Fed chairman, however, is not one to let adulation go to his head. Indeed, he sounded a little worried. He gave warning that an unusually long period of economic stability might have encouraged investors to accept lower risk premiums and thus inflated the prices of assets, such as shares and homes. "History has not dealt kindly with the aftermath of protracted periods of low risk premiums," Mr Greenspan said. In other words, large asset-price booms typically turn to bust.

Moreover, Mr Greenspan, who until recently gave short shrift to the idea of a housing bubble in America, said that the property boom was an "imbalance" and that prices of homes could fall. He argued that in future the Fed will need to pay more attention to asset prices. This does not mean that the Fed is about to start targeting the housing market, but it does now seem to be trying to talk it down. And as long as surging prices keep fuelling consumer spending and inflation is edging up, the Fed is likely to continue to lift interest rates.

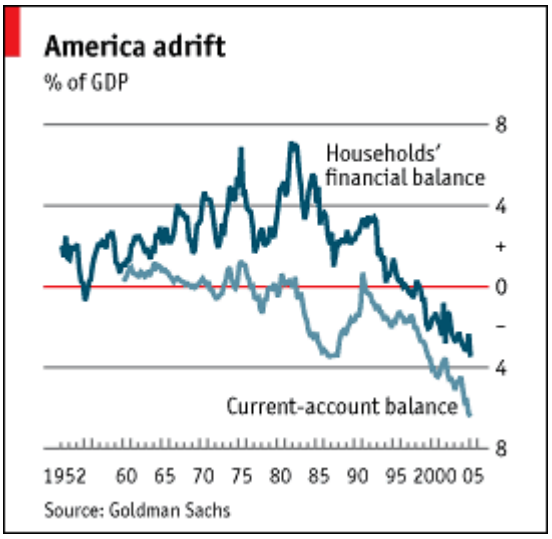
Despite Mr Greenspan's caution, the gathering preferred to focus on his past performance. His chief examiners were Alan Blinder (a former vice-chairman of the Fed) and Ricardo Reis, both of Princeton University, whose paper concluded that “he has a legitimate claim to being the greatest central banker who ever lived”. His track record is certainly impressive. During Mr Greenspan's 18 years, not only has inflation been low, but the economy has suffered only two mild recessions. In the previous 18 years there were four recessions, including the two severest since the Great Depression. His greatest achievement was to spot the spurt in productivity growth in the late 1990s before almost anybody else, allowing the economy to grow faster without fuelling inflation.

According to Messrs Blinder and Reis, the main ingredients of Mr Greenspan's tenure have been intellectual flexibility, scepticism of economic models and forecasts and a preference for discretion over formal policy rules such as inflation targeting. Mr Greenspan's Fed sees monetary policy as risk management, looking not only at the most likely path for the economy but at all the possible paths it might follow. It then attaches extra weight to outcomes that would do severe harm. For instance, in summer 2003, there was a small risk of deflation. Because the consequences of this might have been dire, the Fed pushed interest rates unusually low.

That said, Messrs Blinder and Reis found some flaws in the master's work. First, his opining on non-monetary matters, such as supporting George Bush's tax cuts in 2001, made him look partisan. The Fed should stay out of political issues, lest it rouse Congress to interfere in its business. A second mistake is that America's monetary policy has become too personalised. Mr Greenspan has dominated the Federal Open Market Committee meetings, at which interest rates are set. His replacement by a lesser figure may make markets nervous. In addition, research suggests that in the long run committees are likely to take better interest-rate decisions than individuals.

The big question is: was the Fed right not to try to deflate the stockmarket bubble in the late 1990s? Mr Greenspan has argued that, because it is impossible to identify bubbles at the time and interest rates are an imprecise instrument, it is safer to let bubbles burst of their own accord and then ease policy to support the economy. Messrs Blinder and Reis chided Mr Greenspan for acting as a cheerleader for the new economy: his exuberance over productivity growth probably made the bubble bigger. But they concluded that the mild recession after the stockmarket crashed shows that his “mop-up strategy” is the best way to deal with bubbles.

This part of their assessment is questionable. First, it is too early to conclude that Mr Greenspan handled the stockmarket bubble successfully. Having cut interest rates so hard, Mr Greenspan is leaving the economy unusually out of kilter, with record current-account and household financial deficits (see chart), and America's biggest housing bubble ever. Until these imbalances unwind—most likely, after Mr Greenspan has gone—judgment is premature.



Second, one cannot generalise from a single example that the mop-up strategy is always best. Indeed, this seems at odds with Mr Greenspan's usual disdain for policy rules. Using his risk-management approach, the case for acting against a house-price bubble may be greater than against a stockmarket bubble. A housing bubble will have bigger wealth effects on consumer spending; it is more likely to create financial instability, because people borrow to buy homes; and it is more likely to distort the allocation of resources. There is also the problem of moral hazard: if the Fed always pumps in liquidity after each bubble bursts, it encourages investors to take bigger risks.

In any case, Mr Greenspan's words of caution at Jackson Hole were surely an attempt to lean against the current housing boom—albeit rather belatedly. Perhaps he is showing more intellectual flexibility on how to respond to asset prices than Messrs Blinder and Reis give him credit for.

Changes in the world economy also ought to affect central bankers' thinking. Another paper presented at Jackson Hole, by Raghuram Rajan, the chief economist of the IMF, argued that changes in financial markets (technology, deregulation and institutional change) have increased the incentive for investors both to take greater risks and to move in a herd, pushing prices away from fundamentals. When interest rates are low, this behaviour is compounded by the search for yield. Adding these together makes financial booms and busts more likely.

Meanwhile, inflation is low, thanks partly to competition from China and partly to past monetary policy, which has created the expectation that inflation will stay subdued. The interaction of these new forces makes a mop-up strategy increasingly risky. If central banks slash interest rates every time asset prices fall, but then do not later need to raise them by as much, because inflation remains low, interest rates are ratcheted down. Policymakers are then, in effect, subsidising excessive risk-taking.

If a future conference looks back at the Greenspan era, its conclusions will be less flattering if house prices have fallen, dragging the economy down with them. More economists and Fed officials might then question the doctrine that asset prices are not the responsibility of central banks. Mr Greenspan already seems to be edging in that direction. That, perhaps, is the sign of a true maestro.

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Economist.com FINANCE & ECONOMICS

MasterCard's IPO

Charge

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From The Economist print edition

An initial public offering may herald big changes in retail banking

IN ITS early days, MasterCard had a rough time, lacking the scale to convince shopkeepers that it would bring in shoppers and shoppers that shopkeepers would accept it. Now, MasterCard is one of the best names in one of the best niches in finance. Growth in the credit-card business has been nothing short of remarkable—and keeps on going, as people spurn cash and cheques for the convenience of plastic. In the first half of this year, MasterCard's customer banks had 716m cards in issue, on which $791 billion-worth of transactions were made. Co-operatively owned by 1,400 financial institutions, MasterCard plays a central role in payment processing, as do its chief plastic-card rivals: Visa, a similarly structured competitor, and publicly held American Express.

As a result, the announcement on August 31st that MasterCard would be floated on the stockmarket meant far more than merely the initial public offering of a fair-sized financial company with profits of around $500m a year. The banks are giving up 59% of the group—49% will be floated, 10% will go to a foundation—as well as their shareholder votes. MasterCard is saying little, citing legal constraints on speaking before its flotation, but you can see why it might want to shrug off its myriad parents. The company's future may well rest on its ability to stand on its own, collecting and disseminating funds electronically through smart cards or over the web, unburdened by the cost structure of conventional banks. Its ownership structure is a restraint.

But why, you might ask, would MasterCard's owners, who know a thing or two about finance, want to let it go? Why sell a fast-growing business, especially one whose scale and open, co-operative structure has allowed individual member banks to run their own, nicely profitable credit-card operations?

There are three possible reasons why the banks might have chosen to sell. First and least likely, they may have become less bullish about cards. Growth at MBNA, one of the most dynamic plastic-card companies, has slowed a bit. Recently it tried to sell itself to Wachovia, a big bank, but was rejected. It then peddled itself to Bank of America, a bigger one, which has a history of making deals that are big but not always clever. A second possibility is that collective ownership has become more awkward as banks that once offered their own cards through both Visa and MasterCard have begun focusing on one or the other.

The third reason is antitrust. MasterCard and Visa have long benefited from having exclusive ties to banks. Last October, America's Supreme Court ruled in favour of a case brought by the Justice Department requiring an end to this. Pending litigation, brought by American Express and by Discover, the credit-card arm of Morgan Stanley, alleging anticompetitive behaviour by Visa and MasterCard, could result in large penalties. In the announcement of the offering, MasterCard noted that $650m of the proceeds of the offering will be retained “to defend our interests in the legal and regulatory arena”.

It is possible, therefore, that the banks and MasterCard have decided that the ownership structure has outlived its usefulness, and that they fear being called on to pay for an expensive legal

settlement. If this is the case, it would be ironic if they created an even greater threat to their business by setting MasterCard free.

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Economist.com FINANCE & ECONOMICS

Wal-Mart and financial services

Supercentre banking

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The world's biggest retailer edges into financial services

Get article background

SHOPPING at Wal-Mart is supposed to be about stocking up on potato crisps, stockings and some DVDs, and maybe buying a lawn-mower. Now, if customers have any money left over, they can wire it home. “Money transfers would be to Mexico, and even some to South America,” says James Rash, the manager of a new Austin supercentre, which has a heavily Hispanic clientele. Other services at his store include money orders (46 cents), pay-cheque cashing (up to $3), and express bill payments ($9.50). Business is especially brisk on pay-day, says Mr Rash.

With little fanfare, the world's biggest retailer is starting to flex its muscles in financial services. The company says little about numbers, lumping financial services into “other income”, which accounts for just 1% of revenue. But business is growing fast, says Jane Thompson, head of financial services. Each week Wal-Mart processes more than a million financial transactions. Money orders, introduced in 2001, account for the highest number, but pay-cheque cashing, launched in 2004, is the fastest-growing area. In February Wal-Mart joined up with Discover to offer a credit card with a 1% cash-back on in-store purchases. Wal-Mart's British arm, ASDA, even offers insurance, although Ms Thompson says that is “not on our list this year” for American stores.

In America, something bigger is afoot. In July the retailer applied to open an industrial loan company (ILC) in Utah. ILCs were originally set up about a century ago to help industrial workers take out small loans. Now, they are a favoured route for non-banks to get into banking while side-stepping federal restrictions on the separation of banking and commerce. As of August 1st, 30 institutions, including Target, another big retailer, had ILCs in Utah (which is home to more of them than any other state); Wal-Mart may get its answer from Utah by November. The company also needs the approval of the Federal Deposit Insurance Corporation (FDIC), a national bank regulator.

What does all this portend? For one thing, says Bill Dreher, an analyst at Deutsche Bank, offering financial services is a way to boost customer traffic to the rest of the store. Wal-Mart says its services also fill a need. “We help those who do not have a bank account,” says Ms Thompson. For example, she says, customers without an account may not be able to use a bank to wire money. But since 2003 they have had Wal-Mart, whose low fees are an added attraction. On money transfers, Wal-Mart's flat $9.46 for sending up to $500 to Mexico undercuts the $9.99 next-day service of Western Union, the biggest in the business. Western Union says it “welcomes” the competition.

Wal-Mart's interest has doubtless helped its partners, such as MoneyGram in wire transfers. But smaller banks are rattled. “Wal-Mart has the financial resources to do the same thing to community banks as community grocery stores—to drive them out of business,” says Ron Ence of Independent Community Bankers of America (ICBA), a lobby group.

So far, however, Wal-Mart has been more of a help than a threat to some small banks. For example, Mr Rash's store houses a branch of Woodforest National Bank, based in Houston. A few of Woodforest's services, such as money orders, even compete directly with Wal-Mart's customer-service desk. Over 1,000 Wal-Mart stores have partnerships with banks, some with leases running for another 15 years. “Our goal”, says Ms Thompson, “is never to open a supercentre without a bank.” Still, most local banks “realise they may be dancing with the devil,” says Bert Ely, a banking consultant.

What worries local banks most is the thought that Wal-Mart will get into true branch banking, offering cheque-book accounts and so forth. So Wal-Mart's application to start an ILC has touched a nerve. The AFL-CIO, America's biggest trade-union federation, recently wrote to tell the FDIC that Wal-Mart “could easily become one of the largest banks in the US”, would have a conflict of interest between its retail and banking operations, and “would pose an increased risk of bank failure”. Others are complaining about Wal-Mart's request for exemption from the Community Reinvestment Act (CRA), which requires banks to extend credit help to the local poor, although the retailer says that it plans voluntary work and community donations “in conjunction with the bank”.

Thus far, regulators have agreed with the opposition. Six years ago the retailer tried to buy an Oklahoma thrift, but was thwarted by the passage of the Gramm-Leach-Bliley act of 1999, which strengthened the separation of commerce and financial services. Wal-Mart then attempted a partnership with Toronto-Dominion Bank, a Canadian bank; this too fell through. Three years ago it tried to buy an ILC in California, again without success. A bill that would have allowed Wal-Mart another try for a Californian ILC died this summer in the state legislature; it will be considered again next year.

Wal-Mart says the hubbub about its Utah application is unwarranted. “Our plan is a very small operation with a handful of people,” says Ms Thompson. “It's a bank that a customer won't see—a bank that is really helping us lower cost on debit, credit and electronic-check transactions.” In other words, the bank would help Wal-Mart to process more cheaply payments from customers for its everyday goods. This explains why Wal-Mart thinks the bank should be exempt from the CRA: it would not deal with the public. Before the Gramm-Leach-Bliley act, says Ms Thompson, Wal-Mart was contemplating its own branch bank. But such thoughts are “long gone”, and it is content with its banking partners in stores and the back-office operation in Utah.

Even so, suspicions linger. “There is nothing to prevent Wal-Mart from coming back one to two years from now, when the heat dies down, and amending the application to get into retail operations,” says Mr Ence of ICBA. In theory, that could allow Wal-Mart to open branches in 22 states—but not if Congress approves a House of Representatives bill on interstate branching. Other pending legislation would allow ILCs worth over $100m to offer business cheque-book accounts. The Federal Reserve, though, is among the opponents of this: in June one of the governors testified in Congress that if ILCs want to “become functionally indistinguishable from other insured banks, then they and their corporate parents should be subject to the same rules that apply to the owners of other full-service insured banks.”

Suppose Wal-Mart did want to move into branch banking, and that the regulatory hurdles were cleared: would the retailer succeed? The nearest precedent is not encouraging. In the 1980s Sears Roebuck, a department-store chain, tried to push into financial services. Sears created Allstate (for insurance), and bought Coldwell Banker (property) and Dean Witter (financial planning). Sears also started the Discover credit card and had a savings bank. But Sears's “socks to stocks” efforts flopped, and by the early 1990s it had sold off most of its businesses.

Ms Thompson, as it happens, headed Sears's credit operations from 1993 to 1996, spearheading a push into credit cards. She dodges questions about the comparison, saying only that it will be “very different” this time around. Analysts agree. First, says Mr Ely, Wal-Mart has a low-income,

blue-collar clientele, much of it without bank accounts; Sears's customers were middle-class. And where Sears plunged in with big acquisitions such as Dean Witter, Wal-Mart's efforts have been quieter and limited to simple services such as cheque-cashing. He notes, though, that Wal-Mart has given its customer-service desks (where wire transfers and so forth are offered) premium space, right at the front of the stores, not buried amid the clothes and toys. That is a sign of a business that Wal-Mart intends to be in for a while.

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Economist.com FINANCE & ECONOMICS

KPMG

Taxed

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Another top accounting firm is slammed by the law

ON AUGUST 29th KPMG, one of the “Big Four” global accounting firms, settled a tax-fraud case with the American government that might have threatened its very existence. The charge sheet was impressive: the government claims that between 1996 and 2002, in exchange for $128m in fees, KPMG arranged dubious tax shelters that allowed rich individuals to claim over $11 billion in phoney losses and avoid $2.5 billion in taxes. KPMG agreed to pay fines of $456m and accepted a long list of other conditions, including further monitoring and the end of its tax-advisory business for private clients.

Striking as the punishment is, it matters less than other aspects of the affair. These begin with the criminal prosecution of past employees—which, as this week's agreement makes clear, has been aided by the co-operation of KPMG. Eight former employees, including seven ex-partners (two of whom used to run the firm's tax practice), have been charged with fraud. All eight face the prospect of large fines and long prison terms. Unlike many firms that have paid for the defence of employees facing prosecution for their work, KPMG has capped payments and dismissed dozens of other employees who worked on tax shelters.

Another consequence of the case may be a change in the way accounting firms are managed. In partnerships, those in squeaky-clean bits of the business might grumble at bearing the costs of others' transgressions, but the thought that partners facing prosecution will now be cut adrift might cause some to wonder what “partnership” means.

The greatest significance of the case, however, has less to do with KPMG than with the shadow of Arthur Andersen, which collapsed in 2002 after being criminally indicted for its auditing work on Enron. Clients fled. By the time the jury verdict against Andersen was overturned by the Supreme Court earlier this year, there was no firm to resurrect.

Prosecutors knew that indicting KPMG could prove fatal. The firm's 18,000 people would have been on the street—for a time, anyway. Clients would have been even more vexed. Had the Big Four become a Big Three, there would have been one firm fewer in an industry that is already highly concentrated. Problems would be especially acute where potential conflicts of interest require a company to hire more than one accountant.

If this constrained prosecutors, it was all the more worrying for KPMG executives contemplating what might happen if there were no settlement. As the example of Andersen showed, merely being criminally indicted was equivalent to capital punishment. Instead, a “deferred prosecution” of KPMG has been agreed: all charges will be dismissed at the end of next year if the firm complies with the settlement.

That would certainly be a resolution of a kind. Even though the shelters arranged by KPMG were described as “fraudulent” in this week's announcement, the concentration in the accounting industry has meant that the prosecutors' claim against the firm will not be tested in court.

The shelters went by the simple, quirky names of FLIPs, BLIPs, SOS and OPIs, but like many such devices they were highly complex. Often they were sold to clients who had received large one-off payments for such things as the sale of a business. According to the firm's carefully drafted “statement of facts”, the real violations stemmed not from the tax shelters themselves, but rather how indicted partners conducted themselves: preparing false tax returns, hiding information from the Internal Revenue Service and so forth. Expect the defendants in the case to cast these moves in an entirely different light.

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Economist.com FINANCE & ECONOMICS

Foreign investment in China's banks

Billion-dollar gamble

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Another of China's big banks finds illustrious foreign partners

THREE out of four ain't bad. On August 30th it emerged that China's biggest lender, Industrial and Commercial Bank of China (ICBC), had secured $3 billion in investment from two American financial institutions, Goldman Sachs and American Express, and Allianz, a big German insurer. The three will take a combined 10% stake in the state-owned bank.

The three biggest of China's four main state-owned banks have now found foreign backers. In June Bank of America (BofA) invested $3.1 billion in China Construction Bank (CCB); in July Temasek, Singapore's state investor, put in $1 billion. Last month Royal Bank of Scotland (RBS), Merrill Lynch and Li Ka-shing, a Hong Kong tycoon, bought 10% of China's second-biggest lender, Bank of China (BoC), which on August 31st said it would offload another 10% to Temasek for $3.1 billion. Temasek also promised to spend another $500m on BoC shares at flotation. All three banks are now on course for listings on foreign stock exchanges: CCB will probably go this year, BoC in the spring of 2006 and ICBC in 2007.

For the banks and their regulator, the wooing and winning of such attractive international partners is a triumph. Only two years ago, China's banking industry was burdened by colossal bad loans, understood little about credit risk and had a bureaucratic, antiquated culture. To spruce themselves up for listing, the banks have been selling off their old non-performing loans: they even put their bad-loan ratios in single digits, although the true figures are probably still much higher. Their capital has been bolstered by $60 billion of state money, a quarter of it handed to ICBC in April. And they are hard at work restructuring, shedding jobs and modernising their management. BoC plans to fire and rehire the best of 230,000 people in 11,000 branches and has “tried and penalised” at least 50,000 workers for fraud. The lenders naturally hope to profit from the expertise of their new foreign friends. BoC has already sent its top managers abroad to learn how real banks work. Now their teachers are coming to them.

It is harder to see what the foreigners stand to gain. The investment banks will be hoping to share in the underwriting of the flotations, though fees of a few tens of millions of dollars will hardly recoup their outlay. Commercial banks such as RBS and BofA want to tap the Chinese banks' vast retail clientele. They have joint-venture agreements to offer credit cards, mortgages, insurance policies and investment products to middle-class Chinese. There is certainly an appetite for all these, but it is hard to see them making a profit for years yet. There is also a growing risk that consumer loans will go bad, as China's experiment with car lending has shown.

It may also be that the Chinese banks will simply want to learn the tricks of the trade from their western partners before freezing them out. There are precious few stories of harmonious Sino-western commercial ventures in China. With stakes of only 5-10%, none of the foreign investors will be able to exercise any control when it matters. Even HSBC, an old China hand, which in 2004 paid a fairly modest $1.7 billion for 19.9% of Bank of Communications, China's fifth-biggest lender, has only two board seats and barely a dozen people on the ground after months of co-operation.

Nor, despite due diligence, do the foreigners really know how clean their partners' books are. Bank scandals in China are numerous: witness the removal in March of CCB's chairman for taking bribes. At least RBS has covered itself: it will get some of its cash back if BoC discovers big problems. It seems that investors in ICBC, at least, have agreed something similar.

For the foreign investors, a lot depends on the stockmarket listings. If the flotations go well, the foreigners will make a decent return and can then wait for their longer-term plans to bear fruit. If not, their foray into China might look much less smart. It is hardly reassuring that so much should hang on a stockmarket gamble.

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Economist.com FINANCE & ECONOMICS

Asian consumer credit

Turning Anglo-Saxon

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Are Asians spending more and saving less?

ASIA is known as a region of dedicated savers. Its reputation worries those who want domestic demand to do more to drive growth in the region, and make Asian economies less vulnerable to the vagaries of the global economy.

A recent note by Raffaella Tenconi of Lombard Street Research, an economic-analysis firm, disputes the notion that Asian households do not spend enough. Household borrowing in some East Asian countries, she observes, is going through one of its strongest booms ever. In Taiwan, Thailand and Malaysia, annual growth in household credit has averaged 15-20% in the past six quarters. Household borrowing has been recovering in Hong Kong and South Korea, having contracted sharply in recent busts.

Financial conditions support spending, according to the Bank for International Settlements' (BIS) annual report. Real interest rates are very low. Banks have become more willing to lend to households, having been burned by corporate losses in the Asian crisis of 1997-98. Banks are also healthier: bad-loan ratios are falling, and returns on assets and capital-adequacy ratios are rising. Throw in rising incomes and a growing middle class, and it is easy to see why Asians are loosening their purse strings.

Will the surge in spending last? Ms Tenconi reckons that there is good reason to think so. Banks still have plenty of scope to lend. The financial sector is also evolving: most of these countries now have some form of credit-information system. If banks remain robust and social-security nets are

expanded, spending will be further encouraged. Saving may already be on the way down: Thai households' saving rate fell from 15% of income in 1998 to 6% in 2003. However, total domestic saving in these countries is still very high, ranging from 30% to 45% of GDP.

China is also one of the biggest savers in the world, but there household borrowing is actually slowing down. The government restricted bank lending last year when it realised that a big chunk of mortgages and car loans had gone bad.

Asia's credit-driven spending carries risks, says the BIS. Rapid credit growth can push household debt too high and blow up property prices, to the eventual detriment of the financial sector. Monetary policymakers should watch for such troubles—but in most Asian countries, it looks a bit soon to worry about that.

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Economist.com FINANCE & ECONOMICS

Economics focus

George Maynard Bush

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Most American liberals are now fiscal conservatives. But not all

LIKE all the fiercest debates in American politics, the fight over the budget deficit has its hawks and its doves. But on fiscal matters, it is now the American left that brandishes talons and the right that carries an olive branch in its beak.

One exception is James K. Galbraith, of the University of Texas, Austin. “A card-carrying member of the Texas left”, he is also the whitest of fiscal doves. That makes him a rare bird indeed these days. He shares not only his famous father's initials, but also his sharp pen and his passion for the economics of John Maynard Keynes. In a recent pamphlet* on the budget deficit, Mr Galbraith argues that members of the present Republican administration are unwitting disciples of the Cambridge master.

That administration ran a deficit of $412 billion, or 3.6% of GDP, in the most recent fiscal year. The deficit this year will narrow to $331 billion, according to the Congressional Budget Office. But under some plausible assumptions about congressional budget-making, America's deficits will average about 3.5% of GDP over the next decade, estimate William Gale and Peter Orszag of the Brookings Institution.† By 2014, they project, America's public debt will amount to 55% of its GDP. By 2030, on present trends, debt could reach 139% of GDP.

How much will this matter? Messrs Gale and Orszag think that chronic deficits will eat away at the pillars of American prosperity like “termites in the woodwork”, as Charles Schultze, former chairman of the Council of Economic Advisers, once put it. The coming decade of big deficits will reduce national saving by 2-3% of GDP. As a result, American households will accumulate fewer assets, yielding $1,500-3,000 less income a year.

The deficits serve only to divert resources from investment to consumption, they argue. When taxes are cut, households spend up to 80% of the proceeds, they find. But this extra consumer demand must compete with other claims on a fully employed economy. In their view, extra household spending crowds out investment, dollar for dollar.

Ah, a Keynesian might ask, but what if the economy is not fully employed? Then, says Mr Galbraith, a budget deficit adds to demand in the economy, bringing into play labour and capital that might otherwise have lain idle. These resources might not be put to their best use, to be sure; but what matters is that they are put to some use. The economy is bigger as a result, so even if the deficit reduces investment's share of GDP, it might (at least in principle) raise the actual amount of investment that takes place.

Few could disagree with this logic: it is the basic case for a counter-cyclical fiscal expansion. Even the administration's critics concede that its 2001 tax cuts were impeccably timed (if fortuitously so), boosting consumer demand at a time when many workers were at risk of forced idleness. But as the economy nears full employment, those same critics believe, budget deficits become more damaging.

Doom or Verdoorn?

Mr Galbraith thinks otherwise. America's sustained deficits will help it outgrow the liabilities they leave in their wake, he believes. And if that fails, they will help inflate those liabilities away. As an economy approaches full employment, any fiscal stimulus is dissipated by higher prices. In this case, the stimulus may add nothing to real GDP. But, Mr Galbraith points out, it still adds something to nominal GDP. This will ease the government's debt burden, since it is out of nominal GDP that the government must repay the nominal claims held by its creditors.

Inflation, like devaluation, is a tried and tested way for an indebted government to escape its obligations. It is because it is so tempting that macroeconomic stability is so hard-won and so easily lost. It may be true, as Mr Galbraith suggests, that America would rather let its inflation rate multiply than its debt-to-GDP ratio explode. But why would anyone want either?

In fact, Mr Galbraith is confident that a sustained fiscal stimulus will yield more than just inflation. When demand is strong, innovation quickens, he argues. He cites Verdoorn's law, named after the Dutch economist Petrus Verdoorn, which holds that the pace of productivity growth picks up as the economy nears full capacity. If a government deficit adds to the demands on an economy at full stretch, the economy may find ways to stretch a little further.

There may be a grain of truth to this observation. But Mr Galbraith presumably does not believe in a world without any supply-side constraints, in which the only check on the ingenuity of the American economy is the timidity of its fiscal authorities.

In so far as there is any truth in Verdoorn's law, its practical implications are more modest. It suggests that America's policymakers must test the economy's limits before they can know precisely where they lie. The American economy might, for example, learn to cope surprisingly well with a tight labour market, as it did in the late 1990s. At that time, the Federal Reserve seemed to take the view that faster productivity growth had allowed the unemployment rate consistent with stable inflation to be temporarily reduced. More generally, the Fed knows that it cannot be quite sure exactly where America's natural rate of unemployment and its neutral rate of interest lie.

But if the Fed can be trusted to explore the economy's limits and respect them, Congress cannot. Fiscal policy is made in a spirit of political point-scoring, not macroeconomic inquiry. Given too much licence to roam, Congress would soon reach the economy's outer frontiers—and carry right on over the edge.

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* "Breaking Out of the Deficit Trap: The Case against the Fiscal Hawks". The Levy Economics Institute. June 2005

† "Budget Deficits, National Saving, and Interest Rates"

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Economist.com SCIENCE & TECHNOLOGY

The chimpanzee genome

Sisters under the skin

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Getty Images

The genome of the chimpanzee—mankind's closest living relative—has been sequenced. Comparing it with Man's should help people understand themselves

KARL VON LINNÉ (or Linnaeus, as he is widely known) was a Swedish biologist who devised the system of Latinised scientific names for living things that biologists use to this day. When he came to slot people into his system, he put them into a group called *Homo*—and Linné's hairless fellow humans are still known biologically as *Homo sapiens*. But the group originally had a second member, *Homo troglodytes*. It lived in Africa, and the pictures show it to be covered with hair.

Modern taxonomists are not as generous as Linné in welcoming other species into Man's lofty dominion, and the chimpanzee is now referred to as *Pan troglodytes*. But *Pan* or *Homo*, there is no doubt that chimps are humans' nearest living relatives, and that if the secrets of what makes humanity special are ever to be disentangled, understanding why chimps are not people, nor people chimps, is a crucial part of the process. That, in turn, means looking at the DNA of the two species, for it is here that the differences must originate.

One half of the puzzle has been available for several years: the human genome was published in 2001. The second has now been added, with the announcement in this week's *Nature* that the chimpanzee genome has been sequenced as well. For those expecting instant answers to age-old questions though, the publication of the chimp genome may be something of an anticlimax. There are no immediately obvious genes—present in one, but not the other—that account for such characteristic human attributes as intelligence or even hairlessness. And while there is a gene connected with language, known as *FOXP2*, it had already been discovered. But although the

preliminary comparison of the two genomes made by the members of the Chimpanzee Sequencing and Analysis Consortium, the multinational team that generated the sequence, did not turn up any obvious nuggets of genetic gold, it does at least show where to look for them.

A man's a man for a' that

The two genomes are, indeed, very similar. They differ by only 1.2% over the course of some 3 billion pairs of the genetic “letters” in which the language of the genes is written. In fact, almost a third of the shared genes (each of which is several thousand letters long) are identical in the two species, despite their most recent common ancestor having lived 6m years ago. Many more differ by less than the amount that would be expected if changes were accumulating by random processes. (This suggests that natural selection is actively stopping them changing.)

There were, though, 585 genes that showed differences large enough to have been the result of natural selection for change, rather than stasis, and it is among these that the vital human/chimp differences may be found. Or, at least some of them. For it may be that many of the crucial differences are not in the genes themselves, but in how and when the messages those genes carry are transcribed and translated into the protein molecules that do the work in cells—and thus, ultimately, determine what an organism looks like and how it behaves.

This idea is supported by two observations. One is that a number of genes have been duplicated in humans, but not in chimps. Other things being equal, two copies of a gene turn out twice as much protein as one, and that can make a huge difference to the way a cell works. The other is that a number of the genes that seem to have undergone more rapid evolution in humans than in chimps carry the blueprints for transcription factors. These are special proteins that regulate the transcription of other genes. Change the regulation, and both the amount of protein and the time when that protein is produced may change. If the protein in question is involved in embryonic development, that can have huge consequences for the organism that eventually arises.

All this is speculation, of course. But the researchers did find direct evidence of six blocks of DNA much bigger than individual genes that have swept through the human population due to natural selection since the species diverged. These blocks, known as haplotypes, clearly harbour important stretches of DNA—though, frustratingly, it is hard to say what these are. The uncertainty is the result of a phenomenon known as the hitchhiking effect. The DNA in question has carried its neighbours along for the ride, as they are part of the same block. This makes it impossible to say who, as it were, is the driver and who are the passengers. Indeed, one of the haplotypes does not even contain anything that is recognisable as a gene. The researchers' best guess is that it includes particularly desirable control sequences for a gene just outside the haplotype block.

And then there is *FOXP2*. This gene is known to be involved in language (people who lack a functional version of it cannot learn to speak). And, like the six anonymous lift-givers, the modern human version of it seems to have undergone a selective sweep through the population. But no one knows what this really means.

These are still early days, though. The next few years should see the genetic differences between the species clarified and, more important, a better understanding of just what it is that those differences mean to the way the two organisms work.

A preliminary report on that has been provided by a paper in *Nature*'s rival, *Science*. Svante Paabo, of the Max Planck Institute for Evolutionary Anthropology in Leipzig, Germany, and his team compared patterns of gene expression in five types of tissue taken from the two species. Ironically, the smallest differences were found in brain tissue. The largest were in the liver.

Clearly, there is still some way to go.

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Economist.com SCIENCE & TECHNOLOGY

Mad-cow disease

A twisted tale

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A new theory of the origin of mad-cow disease

SUMMER is the newspapers' silly season, when even the most serious reporters tend towards the "Man bites Dog" school of journalism. "Cow eats Man" is an unusual variation on the theme, but it is no joke this week. In the latest issue of the *Lancet*, Alan and Nancy Colchester, at the universities of Kent and Edinburgh respectively, propose just that to explain the origin of one of the world's most perplexing diseases: bovine spongiform encephalopathy (BSE).

BSE, or mad-cow disease as it is more familiarly known, is a fatal brain disorder that swept through British cattle in the 1980s, and has appeared in almost two dozen other countries, most recently America. BSE is one of a family of so-called prion diseases, such as the human disorder Creutzfeldt-Jakob disease, which are the result of a naturally occurring protein changing shape in such a way as to cause neurological problems. Some prion diseases are caused by hereditary mutations in the gene encoding this protein. Others are acquired by contact with infected material. One of the most alarming examples of the latter is a new form of Creutzfeldt-Jakob disease called vCJD. This has affected more than 150 people in Britain, and is thought to be connected with the consumption of BSE-infected beef.

It is generally believed that BSE spread through the British herd when cattle were given commercial feeds contaminated with the remains of other infected cows. But no one knows exactly how the first cow—the one that started this chain reaction—got infected or why BSE hit Britain in particular so hard so early. One theory is that BSE arose spontaneously through a genetic mutation in a British cow, and that this animal was then processed into the feed chain. Other suggestions are that the infected material came from sheep, which are known to suffer a prion disease called scrapie, or from wild animals such as antelope. But none of these theories fully explains the epidemic.

The Colchesters have another hypothesis. They have turned conventional thinking—that the human disease vCJD came from infected bovine material—upside down and suggested that BSE may have come from cows eating infected human material instead. It sounds far-fetched, even for the grisly practices known to have occurred in the British feed trade in the 20th century. Yet the Colchesters argue that CJD-infected human remains may have been imported into Britain in the 1960s and 1970s from India, from which tonnes of bones and carcass parts came for use as fertiliser and animal feed. The Colchesters suggest that the Hindu practice of consigning the dead to a river, such as the Ganges, may have allowed the bodies of those with CJD to float into the hands of bone collectors, who sold them on to processing mills along with their main haul of animal remains. Poor regulation then allowed this material to make its way into Britain, which was by far the largest importer in Europe at the time, explaining in part why BSE hit Britain so much harder and earlier than other countries. To support the idea that human remains really did get mixed up with those of other animals in this trade, the Colchesters cite an investigation carried out in French and Belgian ports in the late 1960s, and the prosecution of an Indian bone exporter in 2001. The former incident, they say, caused one British animal-feed firm to reorganise its manufacturing process.

It is an interesting idea, but it, too, has its shortcomings. Using data from other places, and given what they consider “inevitable” underestimation of the disease in poor countries due to limited awareness of it and low autopsy rates, the Colchesters estimate that there are 150 cases of CJD a year in India. Yet in the same issue of the *Lancet*, Susarla Shankar and P. Satishchandra at India's National Institute of Mental Health and Neurosciences warn against using prevalence data from other parts of the world, given the impact of genetic differences on susceptibility to the disease. They point out there have been only 85 recorded cases of CJD in India over the past 37 years, making it a very rare disorder. Moreover, they argue that patients dying in hospital tend not to be cast upon the waters, but rather cremated or buried in community burial grounds. And even bodies in the river tend to putrefy, making it difficult to predict how infective they might be.

As the Colchesters admit, “We do not claim that our theory is proved, but it unquestionably warrants further investigation.” They suggest more research be done—for example, attempting to infect cattle with human prions, to see what symptoms develop. They also call for clearer information about past feed-manufacturing practices and whether some countries are still receiving imports of animal by-products mixed with human remains. Given the lack of hard evidence for their hypothesis, it remains only that: a hypothesis. The origins of BSE are as shrouded as ever. But ghoulish as it is, the Colchesters' theory is an intriguing one.

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Economist.com SCIENCE & TECHNOLOGY

Particle physics

Strange behaviour

Sep 1st 2005
From The Economist print edition

Particles that exist only fleetingly help make everyday matter magnetic

IN THE world of particle physics, there is no such thing as nothing. Particles of matter, and their anti-matter counterparts, are forever flitting in and out of existence. Theorists have predicted that the presence of such transient visitors has little effect on everyday life. However, a group of experimental physicists has just shown this view to be mistaken.

Atomic nuclei are bundles of protons and neutrons which, along with electrons, are the basis of matter. But protons and neutrons themselves are made of more fundamental particles called quarks. These quarks have fractional electrical charges and combine to give each particle its overall electric charge, whether positive in the case of protons or neutral in the case of neutrons. They also give each particle its magnetic properties.

As well as possessing electric charge, quarks come in one of six “flavours”: up, down, strange, charm, bottom and top. A proton, for example, consists of two up quarks and a down quark, while a neutron consists of two down quarks and an up quark. But besides these permanent quarks, quantum theory predicts that so-called virtual quarks, together with their anti-matter partners, are continuously emerging from the vacuum of space and then disappearing again as a result of Heisenberg's uncertainty principle. So, while a proton has three resident quarks, it also plays host to a lot of short-term visitors. These are mostly up and anti-up, or down and anti-down, but also, occasionally, strange and anti-strange quarks. These guests add their properties to the mix.

A team of physicists at the Thomas Jefferson National Accelerator Facility in Virginia, led by Douglas Beck, decided to investigate just how much of a contribution the visitors make. They did so by probing the interior of protons (in the form of the nuclei of hydrogen atoms) with fast-moving electrons. By analysing the subsequent trajectories of the particles, they could pinpoint the effect of the visitors. The results, reported in this week's *Physical Review Letters*, showed that this was far greater than had been predicted. In particular, some 5% of a proton's magnetism is contributed not by the host quarks but by visiting strange quarks that have popped out of nowhere.

The magnetism of protons is exploited in the medical technique known as magnetic-resonance imaging (MRI). Patients are placed in a strong magnetic field that aligns the magnetic fields of the protons in their bodies. The protons are then stimulated by radio waves which “unalign” them, and the energy they release as they return to their original alignments gives away their position. Since different tissues have different compositions (and thus different densities of protons), this signal can be turned into a picture of what is going on inside a body. So, next time you have an MRI scan, remember that part of the picture depends on something that isn't really there. Strange, eh?

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Economist.com SCIENCE & TECHNOLOGY

Scientific accuracy

...and statistics

Sep 1st 2005
From The Economist print edition

Just how reliable are scientific papers?

THEODORE STURGEON, an American science-fiction writer, once observed that “95% of everything is crap”. John Ioannidis, a Greek epidemiologist, would not go that far. His benchmark is 50%. But that figure, he thinks, is a fair estimate of the proportion of scientific papers that eventually turn out to be wrong.

Dr Ioannidis, who works at the University of Ioannina, in northern Greece, makes his claim in *PLoS Medicine*, an online journal published by the Public Library of Science. His thesis that many scientific papers come to false conclusions is not new. Science is a Darwinian process that proceeds as much by refutation as by publication. But until recently no one has tried to quantify the matter.

Dr Ioannidis began by looking at specific studies, in a paper published in the *Journal of the American Medical Association* in July. He examined 49 research articles printed in widely read medical journals between 1990 and 2003. Each of these articles had been cited by other scientists in their own papers 1,000 times or more. However, 14 of them—almost a third—were later refuted by other work. Some of the refuted studies looked into whether hormone-replacement therapy was safe for women (it was, then it wasn't), whether vitamin E increased coronary health (it did, then it didn't), and whether stents are more effective than balloon angioplasty for coronary-artery disease (they are, but not nearly as much as was thought).

Having established the reality of his point, he then designed a mathematical model that tried to take into account and quantify sources of error. Again, these are well known in the field.

One is an unsophisticated reliance on “statistical significance”. To qualify as statistically significant a result has, by convention, to have odds longer than one in 20 of being the result of chance. But, as Dr Ioannidis points out, adhering to this standard means that simply examining 20 different hypotheses at random is likely to give you one statistically significant result. In fields where thousands of possibilities have to be examined, such as the search for genes that contribute to a particular disease, many seemingly meaningful results are bound to be wrong just by chance.

Other factors that contribute to false results are small sample sizes, studies that show weak effects (such as a drug which works only on a small number of patients) and poorly designed studies that allow the researchers to fish among their data until they find some kind of effect, regardless of what they started out trying to prove. Researcher bias, due either to clinging tenaciously to a pet theory, or to financial interests, can also skew results.

When Dr Ioannidis ran the numbers through his model, he concluded that even a large, well-designed study with little researcher bias has only an 85% chance of being right. An underpowered, poorly performed drug trial with researcher bias has but a 17% chance of producing true conclusions. Overall, more than half of all published research is probably wrong.

It should be noted that Dr Ioannidis's study suffers from its own particular bias. Important as medical science is, it is not the be-all and end-all of research. The physical sciences, with more certain theoretical foundations and well-defined methods and endpoints, probably do better than medicine. Still, he makes a good point—and one that lay readers of scientific results, including those reported in this newspaper, would do well to bear in mind. Which leaves just one question: is there a less than even chance that Dr Iaonnidis's paper itself is wrong?

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Iraq

A grim chronicle

Sep 1st 2005
From The Economist print edition

AP

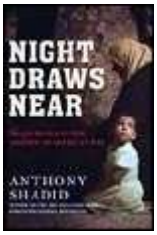
The war in Iraq has been widely reported, but thinly understood. A new book, by an Arabic-speaking American journalist, sets out to right that wrong

“AT 5:34am, on Thursday March 20th 2003, the United States began a war of its own choosing, buoyed by grand ambition and perhaps folly.” Its declared reason—to wrest terrifying weapons from Saddam Hussein—was bogus or a delusion; its plan for the occupation that followed a scribbled afterthought; some 25,000 Iraqi civilians and 2,000 American and British troops have since been killed in chaos that may yet wreak civil war.

Much more than these bold facts, however, the average western newspaper reader will not know. It is not easy to understand fully what is going on; still less so to make any accurate predictions about how it will end. Targeted by head-chopping Muslim fanatics, most foreign journalists do not leave the generous, if inevitably jaundiced, embrace of American and British troops. And even those who do must rely heavily on official sources—mostly Americans who are out of touch with the complex and changing world outside their fortress compounds, and who, like their government, have tended also to invent good news where there is none.

Thank goodness, then, for those reporters, both western and Iraqi, who are prepared to take risks in search of a more nuanced reality, among them Anthony Shadid, a correspondent for the *Washington Post*, whose words begin this article. Mr Shadid, an American of Lebanese descent, who speaks Arabic like a native and writes English like an angel, has put his best reporting into this book. Even-handed and keenly observed,

Night Draws Near: Iraq's People in the Shadow of America's War
By Anthony Shadid



Henry Holt; 448 pages; $26

Buy it at
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containing just enough (and no more) of the author to suggest a decent man worthy of our trust, it is written for the inexpert but has fresh material for scholars. Mr Shadid calls his work story-telling rather than serious criticism, and so it is. But stories this insightful—of dead Iraqi insurgents and their motivations; of a 14-year-old Iraqi Anne Frank, with extracts from her wartime diary—are more than journalism; they are valuable chronicles.

For several weeks before the war, until the spring of 2004, when a Shia insurgency under Muqtada al-Sadr erupted in central and southern Iraq, in addition to the Sunni resistance blazing in the west, Mr Shadid embedded himself among ordinary Baghdadis. His method was “to ask endless questions in face-to-face conversations in the cramped rooms of street-corner mosques.” When American troops arrive in Iraq's capital, he speaks to the minority waving to greet them, also to those who wish to kill them and to the worried majority waiting to see what they would bring. It is an excellent method. Soon after, in a suburb of Baghdad, Mr Shadid follows the trail of an American foot-patrol which a colleague of his had accompanied. Afterwards, the two journalists compare notes. Beaming, the soldiers considered the locals “99% friendly”. After they have passed, Mr Shadid finds sullen crowds who are bitterly resentful, at best, of the helmeted and booted invaders.

Mr Shadid writes engagingly about history and lyrically about destruction. (“The hospital ward was littered with blood-soaked gauze, the stretchers and blankets themselves bore scabs”.) He writes about the Americans in Iraq scarcely at all. The reader comes to see them almost through Iraqi eyes, as distant and dangerous, their presence expressed by absence—of electricity through a burning summer, and of security, when Baghdad is ransacked as the Baathist regime folds. Where Americans do come in, Mr Shadid prefers to let them damn themselves. Why, one startled English-speaking Iraqi asks, did the tank that advanced on his village have “We remember 9/11” written on its gun-barrel? In the Baghdad citadel, the “Green Zone”, from which America ruled Iraq, Mr Shadid encounters a breed of chirpy young Republicans, unflaggingly loyal to their government and wholly inadequate to their tasks: “Iraqis rock!” two of them tell him.

While America's leadership bragged of bringing freedom (a “catchphrase it used reflexively,” he says), Mr Shadid asks again and again the question thrown up during the 7th-century squabble between Sunni and Shia Muslims in Iraq, which has not been settled since: “Who has the right to rule, and from where does that right arise?” In the flourishing of radical Islam and nationalism after the invasion, that turned Shia and Sunni against each other and both groups against the invader, he sees a breakneck bid to supply the answer. So too in the democratic process that America and its allies hastily, if belatedly, introduced, with elections last January. Which logic will prevail, war and domination, or negotiation and compromise, Mr Shadid is careful not to try to predict.

Even if, against the odds, Iraqis manage to avert worse violence, history will still condemn America for its blundering in their country. Mr Shadid lists the mistakes dispassionately, including those well known—the insufficient number of occupying troops, the disbanding of Iraq's security forces—and those less advertised, that the Sadrist uprising began after an American helicopter rammed a sacred Shia flag for fun, or that the resistance in Fallujah began after American troops there massacred 15 unarmed protesters.

And yet, he asks, even without all these errors, was the occupation's failure inevitable? Mr Shadid suggests that it was. Brutalised over two decades, yet still bristling with ancient pride and possessing no common idea of how their country should be, Iraqis were ripe for revolt the day the dictator's boot was lifted from their throats. And America, a well-meaning but ignorant occupier, widely distrusted across the Arab world because of its backing for Israel, was hopelessly ill-equipped to quell them. “Not insubstantial were decades over which the United States had grown as an antagonist in the eyes of many Arabs. Iraq had long been removed from the Arab world, isolated by dictatorship, war, and sanctions, but it remained Arab.”

Night Draws Near: Iraq's People in the Shadow of America's War
By Anthony Shadid
Henry Holt; 448 pages; $26

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Economist.com BOOKS & ARTS

Scottish history

Clearing the air

Sep 1st 2005
From The Economist print edition

ACADEMICS who challenge received wisdom are often given a tough time. Michael Fry's history of the Scottish Highlands has been greeted with a volley of insults, the most ludicrous comparing him with David Irving, a writer who denies that the Holocaust ever happened.

Mr Fry's offence is to have tackled what is generally regarded as one of the most shameful episodes of Scottish history—the Highland clearances. The accepted view is that in the early 19th century, hard-hearted, wealthy aristocrats brutally cleared their estates of tens of thousands of farming tenants to make way for (more profitable) sheep. Many of the evicted emigrated to America; the stayers eked out a miserable subsistence from fishing and small-holding on barren coastal strips.

Mr Fry does not deny that some brutalities did occur. But, he says, they were the exception rather than the rule, otherwise the Highland population could not have risen as it did from 337,000 in 1755 to more than 400,000 in 1841. This explosion, he argues, made traditional agriculture—which was marginal at best in much of the Highlands—quite uneconomic.

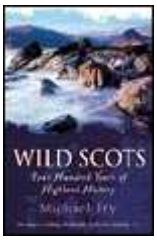
A few landowners responded with evictions. But many more spent huge sums trying to build an alternative economy. Mr Fry estimates that the Countess of Sutherland spent about £100m ($178m) in today's money shifting tenants to coastal towns with new industries such as fishing and mining. Only when these experiments failed did emigration (much of it paid for by landowners) increase, leading to a drop in population in the late 1800s.

At the beginning of Mr Fry's period the Highlands were virtually a different nation from the Lowlands of Scotland. Behind their impenetrable mountains, language, social structure and the whole way of life were distinct. Lowland Scots regarded Highlanders with distrust as dangerous and troublesome neighbours. Curiously though, and largely as a consequence of the influence of Sir Walter Scott, both Highlanders and Lowlanders “now regard themselves as members of one nation”.

Could Scotland and England follow a similar course and become indistinguishable in a common Britishness? This is the theme of Allan Massie's book. It is something which he would like to see, but he does not pretend that it is easy or probable. England and Scotland, he says, are “two nations with different traditions”.

Britain began as a consequence of England's wars with France. England could not tolerate an independent Scotland which might again renew its traditional alliance with France and therefore

Wild Scots: Four Hundred Years of Highland History
By Michael Fry



John Murray; 378 pages; £25.00

Buy it at
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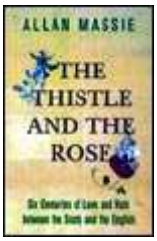
The Thistle and the Rose: Six Centuries of Love and Hate Between the Scots and the English
By Allan Massie



John Murray; 326 pages; £20

Buy it at
Amazon.com
Amazon.co.uk

insisted on an “incorporating union”. As Mr Massie says, “in any union between a large and rich country and its smaller and poorer neighbour, the former surrenders little of value while the latter fears to lose much.” Many Scots—as anti-English as they are anti-landowner—would say that this is still true.

In his wish for Scotland and England to be indistinguishable, Mr Massie is wishing pigs might fly. Mr Fry's version of Scottish history has led Brian Wilson, a former Labour MP, to label him a “clearance-denier”. The bad name given to landowners by Mr Wilson and others is partly why Scotland leans politically further left than the rest of Britain. Mr Massie's wishes are innocent; in his challenge to the leftist consensus, Mr Fry is shaking the foundations of the newly devolved Scottish state. That, in some eyes, is a real crime.

Wild Scots: Four Hundred Years of Highland History.
By Michael Fry.
John Murray; 378 pages; £25.00

The Thistle and the Rose: Six Centuries of Love and Hate Between the Scots and the English.
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Economist.com BOOKS & ARTS

East Timor

A savage road to peace

Sep 1st 2005
From The Economist print edition

THIS is a powerful and moving reminder of the horrors visited on East Timor, a tiny scrap of land that was exploited and neglected by its Portuguese colonisers for 420 years, repeatedly butchered and raped by the Indonesians from 1975 on, and now enjoys a precarious independence as the newest, and one of the poorest, countries on earth. The slaughter that was visited on East Timor after the Indonesian invasion was, in proportionate terms, one of the bloodiest ever. As many as 200,000 people died, a third of the territory's population.

The memory of the killing haunted the occupation. Indonesians tried harder to develop Timor than the Portuguese ever did, but their guilt made them uneasy. Any attempt by the East Timorese to assert their right to justice, let alone to self-determination, was met with brutal responses, culminating in a massacre in the Santa Cruz cemetery in 1991. When the Indonesian dictator Suharto fell in 1998, his successor offered the Timorese a vote on independence. They seized the opportunity, but the Indonesian army—with the Timorese militias it had spawned—left only scorched earth and ruined buildings behind.

A Not-So-Distant Horror: Mass Violence in East Timor
By Joseph Nevins

Cornell University Press; 273 pages; $49.95 and £25.95

Buy it at
Amazon.com
Amazon.co.uk

All of this is well recounted by Joseph Nevins, an assistant professor of political geography at Vassar College in New York state. Where Mr Nevins moves on to more troublesome ground is when his book attempts to enlarge the circle of blame for all three atrocities, 1975, 1991 and 1999, beyond where it most obviously belongs—with the Indonesian armed forces and government. He accuses all western governments, but principally those of America, Australia and Britain, of “complicity” in the carnage. Complicity is a slippery word, but there is a degree of truth in what he says. America, in particular, could have done much more to put pressure on the Indonesians to rein in their dogs of war, and America in effect gave Suharto the green light to move in 1975. All three countries clearly should have raised their voices in angry condemnation—but failed to do so. In 1975 the British ambassador in Jakarta cabled London advising British diplomats to “keep our heads down” when the matter was debated at the UN.

What niggles when reading Mr Nevins, though, is that he never attempts to explore reasons why the West felt it necessary to support Suharto in his occupation. One would not guess from his pages that when East Timor was invaded, it had shortly before been taken over by a communist-leaning government: that Saigon, Phnom Penh and Vientiane had all fallen to the communists earlier that year; that Suharto himself had come to power following dreadful misgovernment and a flirtation with communism in Indonesia, by far the largest country in South-East Asia. Alone, such considerations may not counter the charge of “complicity”, but Mr Nevins should at least have tried to grapple with them.

By 1991, and especially by 1999, these explanations anyway carry far less weight. Mr Nevins's accusations are particularly powerful when it comes to the lack of action following the Santa Cruz

massacre in 1991. He understates the depth of world concern in 1999, which did, after all, lead to speedy UN resolutions and the mustering of a peacekeeping force under Australian command. It should, of course, have acted much faster, but that has much more to do with bureaucratic inertia than complicity.

A Not-So-Distant Horror: Mass Violence in East Timor
By Joseph Nevins
Cornell University Press; 273 pages; $49.95 and £25.95

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Amazon worldwide bestselling novels

Smothered in HP

Sep 1st 2005
From The Economist print edition

More blanketing than sauce, Harry Potter 6 outdoes them all

THOSE who read only three books a year have been spoiled for choice this summer once they have got through Harry Potter and "The Da Vinci Code": a medieval thriller, an Afghan boy wonder, a heroic quest fantasy, a killer cowboy and acres of penis envy. The full cupboard of life, really.

1. Harry Potter and the Half-Blood Prince.
By J.K. Rowling. Scholastic; 672 pages; $29.99. Bloomsbury; £16.99

Garagemen in Beirut were selling it; fishermen on the Greek island of Hydra too. So many people applied for a box of HP+HBP to sell that well over 10m copies changed hands in the first 24 hours after it came out and many, many thousands more since.

Click to buy from Amazon.com or Amazon.co.uk

2. Harry Potter und der Halbblutprinz.
By J.K. Rowling. Carlsen; 656 pages; €22.50

One of the first foreign-language editions to reach the bookshops, HP in German proves more popular than ever.

Click to buy from Amazon.de

3. The Historian.
By Elizabeth Kostova. Little, Brown; 656 pages; $25.95 and £14.99.

A thriller that opens in Amsterdam when a teenage girl discovers a medieval book and a cache of yellowing letters in her diplomat father's library.

Click to buy from Amazon.com or Amazon.co.uk

4. The Kite Runner.
By Khaled Hosseini. Riverhead; 384 pages; $14. Bloomsbury; £7.99

This eloquent novel, exloring pride, honour and betrayal in America and Afghanistan, just keeps flying off the shelves.

Click to buy from Amazon.com or Amazon.co.uk

5. Eldest (Inheritance, Book 2).
By Christopher Paolini. Knopf; 704 pages; $21. Doubleday; £14.99

Second volume of a classic heroic quest fantasy that was launched two years ago when the author was only 17.

Click to buy from Amazon.com or Amazon.co.uk

6. Harry Potter. Books 1-5, paperback boxed set.
By J.K. Rowling. Scholastic; $40.95. Bloomsbury; £33

For those who have only just learned to read, or for the laggards and late starters who need to catch up fast.

Click to buy from Amazon.com or Amazon.co.uk

7. The Da Vinci Code.
By Dan Brown. Doubleday; 454 pages; £24.95. Corgi Adult; £6.99

Hair shirts and hermits, murder and mayhem. Is there anyone left who hasn't read it?

Click to buy from Amazon.com or Amazon.co.uk

8. Until I Find You.
By John Irving. Random House; 848 pages; $27.95. Bloomsbury; £18.99

John Irving has lots of fans. That, or there are thousands out there willing to pay for 1.4kg of penile obsession.

Click to buy from Amazon.com or Amazon.co.uk

9. No Country for Old Men.
By Cormac McCarthy. Knopf; 320 pages; $24.95

America's most famous south-westerner is back with a book specially crafted for those who loved "All the Pretty Horses" but can't take "Blood Meridian".

Click to buy from Amazon.com or Amazon.co.uk

10. Das Souvenir des Mörders.
By Ian Rankin. Goldmann; €9.95

Edinburgh's second-most famous writer after J.K. Rowling heads off in German—to great acclaim.

Click to buy from Amazon.com or Amazon.co.uk

Global sales from Amazon.com, Amazon.co.uk, Amazon.de, Amazon.fr and Amazon.jp from August 1st-30th 2005. Prices are correct as of August 30th 2005.

Economist.com BOOKS & ARTS

Henri Cartier-Bresson

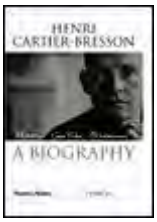
Cameraman

Sep 1st 2005
From The Economist print edition

HENRI CARTIER-BRESSON wanted to be famous on condition that he remain unknown. That contradiction is all too apparent in Pierre Assouline's biography of the French photographer—dubbed "the eye of the century"—published in English to coincide with a retrospective of Carter-Bresson's work in Edinburgh. Mr Assouline, who edits a French literary magazine, *Lire*, has based his book on a series of conversations and letters exchanged with Cartier-Bresson in the decade before his death in August last year at the age of 95. The old man would not hear of a biography, while knowing that Mr Assouline would disobey.

A key to Cartier-Bresson's ambivalence lies in his family background. Born the eldest son of rich yet austere cotton-thread manufacturers from Normandy, he was brought up to believe that there was something repugnant about seeking out the limelight. Trained as a painter, he was also embarrassed by money and class, though the way he spoke, "pronouncing words delicately from the tip of his tongue", revealed rather more about his social origins than he might have wished.

Henri Cartier-Bresson: A Biography
By Pierre Assouline



Thames & Hudson; 386 pages; $34.95 and £20

Buy it at
Amazon.com
Amazon.co.uk

The photographer combined a restless energy with a genius for composition. Truman Capote described the volatile Frenchman at work in New Orleans in the late 1940s as "dancing along the pavement like a frantic dragonfly...doing his clickety-clicks with a joyous intensity and religious fervour that filled his whole being." But it was only at the age of 24, after seeing a lyrical picture by Martin Munkasci, a Hungarian photographer, of some naked African boys running into Lake Tanganyika, that he saw his future: "It is the only photograph that influenced me," he would write towards the end of his life. "There is such intensity in this image, such joie de vivre."

Mr Assouline crams his tribute with details and stories about the photographer who was present at some of the great upheavals of the 20th century: the Spanish civil war, the liberation of Paris in 1945, the fall of the Kuomintang in China to the communists and the assassination of Mahatma Gandhi, along with his friendships, among others, with Max Ernst, Alberto Giacometti and Jean Renoir.

Mr Assouline's introduction is titled "hero and friend", and his book suffers to a degree from an obeisance to its subject that is quite un-Anglo-Saxon. A photographer who loathed being photographed, Cartier-Bresson believed that what went on beneath the surface was nobody's business but his own. He liked to recall how he once told secrets he had never confided to anyone before to a Paris taxi driver, certain that he would never see the man again. Cartier-Bresson unveiled no such secrets to his biographer, who was happy to respect the privacy of the photographer's private life as the price he had to pay for writing about his hero. The result is polite, but too paltry to be truly pleasing.

Henri Cartier-Bresson: A Biography

By Pierre Assouline
Thames & Hudson; 386 pages; $34.95 and £20

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Economist.com BOOKS & ARTS

Thrillers

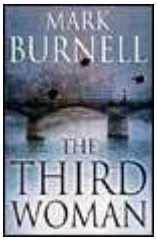
His hard-core woman

Sep 1st 2005
From The Economist print edition

Mark Burnell is becoming one of Britain's most accomplished thriller writers

THE heroine of “La Femme Nikita”, a stylish thriller by Luc Besson, is a vagrant petty criminal and drug addict. In a bungled raid on a Parisian pharmacy, she shoots a policeman and is captured. Reported as having been killed herself, Nikita in fact survives in secret. Given one last chance at life under a new identity, she is trained to kill for the French state, her employers a shadowy government department that handles the intelligence dirty work nobody else will touch. Nikita leads a double life: one minute she is a finely honed assassin, the next she becomes your average middle-class Frenchwoman.

The Third Woman
By Mark Burnell



HarperCollins; 371 pages; £12.99

Buy it at
Amazon.com
Amazon.co.uk

Mark Burnell freely admits that his early inspiration for Petra Reuter, the heroine of his four engaging thrillers, of which “The Third Woman” is the latest, came from Nikita. How would such a woman exist, he asks, how would she handle life under two or more fictitious identities as she rampages through a demi-monde of organised crime, international terrorism and undercover assassination? Readers can find out by picking any of his books at random, but literary justice is best served by starting at the beginning with “The Rhythm Section”, an *Economist* book of the year in 1999, in which the complex character of Petra was created.

Petra begins life as Stephanie Patrick, a smart, truculent, reactionary child from rural Northumberland, whose parents are killed in a terrorist bombing of an airliner over the Atlantic. The reader first meets Stephanie, or Petra, in the guise of Lisa, an embittered, self-destructive London prostitute heading for an early death from drink and drugs. When a journalist tells Lisa that her family were the victims of an international Islamic terrorist plot, Lisa, with nothing to lose, determines revenge.

Just about to pull the trigger on one of the suspected plotters, Lisa is kidnapped by British undercover agents whose target is the same as hers. It transpires they operate on behalf of Magenta House, a faceless British intelligence organisation run by a loathsome and ruthless man called Alexander, who gives Lisa a simple choice. Come and work for Magenta House under a new identity or return to a sure and sorry demise as Lisa the prostitute.

So she does, and the central female character, under the guises of Petra Reuter and Stephanie Patrick, emerges. Forty-year-old Mr Burnell was born in Northumberland and raised in Brazil. Returning to Britain, he worked as a stockbroker and a barman before turning to writing nearly a decade ago. He is a gifted storyteller and a master of plot; his imagination surpassed only by a devotion to accurate, topical, factual research. Yet he never falls into the trap of allowing that research to drown his work. Instead, Mr Burnell has made great efforts to create a subtle central character; nuanced, complicated, yearning and tortured. Petra/Stephanie is perhaps the most

engaging star of any thriller since Frederick Forsyth's Jackal, a tribute to the view—now, sadly, all too rarely followed in contemporary, made-for-TV thriller-writing—that character is more important than plot.

Trained by a merciless ex-Special Forces operative in the Highlands of Scotland, Petra embarks on her life as a proficient, imaginative, world-class assassin. Her targets are the protagonists of contemporary international crime and terrorism: Islamic fundamentalist hijackers in the first book, Russian gangsters dealing in stolen biological weapons in “Chameleon”, the second, Balkan war criminals in “Gemini”, and in the latest, an avaricious, murderous American corporation with close links to international crime.

Mr Burnell's plots twist and turn with convincing realism, but the star of the show is Petra, under all her different guises, as she wages a permanent internal war with herself, Petra versus Stephanie—outrageous, curiously lovable and chilling assassin versus a woman longing for a normal existence.

Men ricochet in and out of her life as she struggles to rid herself of the hold that the hated Alexander and Magenta House have over her. Who is the greater villain, her employers or her victims? Who will prevail, Petra or Stephanie? All four books have been bought by New Line Cinema, which made “Lord of the Rings”. Mr Burnell is writing the script of the first book. Until the film is released, the surest way to plumb the depths of Stephanie/Petra is not just to buy the latest in the series, but to buy all four books and read them in one go—an 1,800-page feast of words, written to a standard far superior to almost anything on offer from other English-language thriller writers. Mr Burnell and his hard-core woman are definitely a pair to watch.

The Third Woman
By Mark Burnell
HarperCollins; 371 pages; £12.99

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Obituary

Robert Moog

Sep 1st 2005
From The Economist print edition

Hulton Getty

Robert Moog, an electronic-music pioneer, died on August 21st, aged 71

IN ONE sense, music went electric in the 1950s when companies such as Fender and Gibson began mass-producing electric guitars. But that was only half a revolution. The music was electronically amplified, but the original sound was still generated by mechanical vibrations, as it had been for thousands of years.

Glimpses of an all-electronic future had been offered since the end of the 19th century. The Telharmonium, a 200-ton mechanical ancestor of the Hammond organ designed to be played down the telephone, had allowed musicians to tinker with sound waves to produce interesting new noises as early as 1897. From 1920 the Theremin, played by waving one's hands in front of two radio receivers, generated eerie electronic *glissandi* without any moving parts.

In 1955 RCA, an American industrial company, combined these innovations in their Mark II Synthesiser, which used electric currents both to generate and manipulate sound waves. The Synthesiser was “played” using a binary programming language stored on punch tape, and it filled a whole room at the University of Columbia. Electronic music seemed destined to remain a curiosity—until, in 1964, a shy young man called Robert Moog, a graduate student at Cornell University, unveiled his own analogue synthesiser at a meeting of America's Audio Engineering Society.

Mr Moog's background was ideal. He had been the class swot in Queens, and bullied for it. His mother had nagged him to become a concert pianist; his father, who loved to tinker with

electronics, had kept him amused out of class by helping him to build a Theremin, whose subtleties enchanted him. His analogue synthesiser was elegant, turning a room-sized machine into something that could be set up in a recording studio; and it was musician-friendly, with a keyboard just like the one his mother had kept his nose to.

Musicians wishing to master the instrument still had to learn a new vocabulary of waveforms, oscillators and filters. But it was a rewarding study. Synthesisers can generate an almost infinite variety of sounds, ranging from simulated guitars or pianos to, as Jim Morrison of The Doors once claimed, “the sound of broken glass falling from the void into creation”.

News of the invention spread fast. In 1968 it found fame when Walter (now Wendy) Carlos, an early practitioner of electronic music, released “Switched-on Bach”, a hit album of Bach recorded entirely on Mr Moog's equipment. But the instrument's big impact was on popular music. The dark, druggy, disillusioned pop *Zeitgeist* of the late 1960s exactly suited the weird sounds made by the new machine. The Beatles used a Moog extensively on their late album “Abbey Road”. Emerson Lake and Palmer, an early progressive rock band, were so enamoured of Moogs that they took one on tour with them, despite its bulk and delicate temperament.

Music to the masses

Other firms were quick to realise the potential of the new invention. By the 1970s, there were several competing models. Mr Moog continued to innovate, introducing in 1970 the smaller, portable Minimoog that allowed electronic music to get to night clubs or the beach. He kept at the cutting edge until the 1980s, and the arrival of computer-based digital synthesisers. Even now, some musicians—Fatboy Slim, for one—continue to prefer the warm, analogue Moog sound.

His invention kick-started electronic music, both as an influence on mainstream music and as a sub-genre in itself. Bands such as Pink Floyd spearheaded the new sound, their music featuring long keyboard solos that seemed to originate in the emptiness of outer space. Stevie Wonder brought the synthesiser to a more mainstream audience; Herbie Hancock helped introduce it to jazz fans. Later, Kraftwerk and similar groups released entire albums of ghostly, futuristic music made without a traditional instrument in sight.

For all his electronic and musical talent, Mr Moog was no businessman. He had begun well enough, making a packet as a young man by selling build-it-yourself Theremin kits, but after he had invented his synthesiser he could not manage its success. When Moog Music was bought by a firm called Norlin, he was relegated to minor musical-engineering tasks.

He left in 1977, setting up another company, Big Briar Productions, and working on a variety of strange new instruments that he hoped would allow musicians even greater expressiveness. (His ideal, for all his modernity, was to produce an electronic instrument that could be played with the human emotion of a cello or a flute.) None of his later inventions had the same impact as his original synthesiser, but that didn't bother him. He saw himself as a simple “toolmaker”, working to give other musicians the sounds they wanted. He rejected the idea that he had democratised electronic music; that, he insisted, had been achieved by cheap Japanese keyboards in the 1980s.

Here, at least, he was mistaken. Without his inventions, thousands of composers in almost every conceivable genre of music—and millions of their listeners—would have been restricted to the familiar sounds of traditional instruments. And music would have been the poorer for it.

Overview

Sep 1st 2005
From The Economist print edition

The **oil price** traded above $70 a barrel, after Hurricane Katrina shut down about 10% of America's refining capacity.

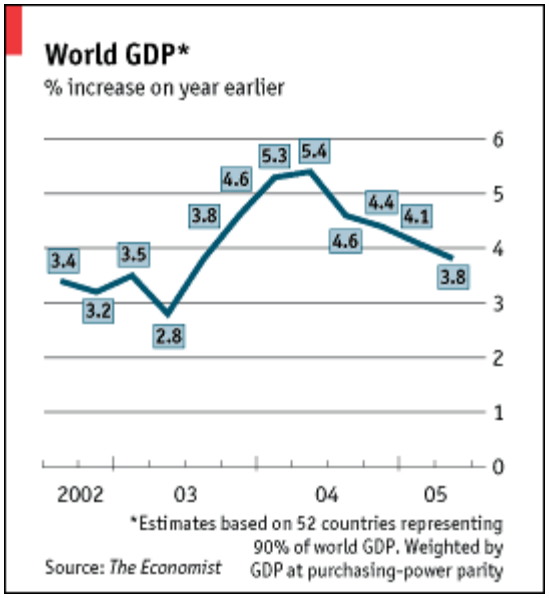
In **America**, the Conference Board's consumer-confidence index rose to 105.6 in August, lifted by an improving job market. But the Chicago PMI fell below 50, much worse than analysts' average forecast of 61.5.

Inflation in the **euro area** slowed to 2.1% in the year to August. Meanwhile, unemployment improved in its two biggest economies: **Germany's** unemployment fell by 12,000 in August, although its jobless rate held at 11.6%; in July, **France's** unemployment rate dropped below 10% for the first time in almost two years.

Japan's latest economic figures were mixed. Industrial output fell by 1.1% in July, to give a 12-month decline of 2.2%. Its unemployment rate rose to 4.4% in July, up from 4.2% in June. And yet this is still lower than 4.9% a year ago. Moreover, the ratio of job offers to applicants rose to its highest since October 1992. The brightest spots were housing starts, which rose by 8.3% in the year to July, to their highest level since 1997, and consumer prices, which fell by only 0.3% over the same 12 months.

In **Britain**, the annual growth in mortgage lending slowed to 10.4% in July, its weakest in three and a half years.

Global GDP growth has slowed this year. Based on those countries that have published their second-quarter figures, *The Economist's* world GDP indicator grew by 3.8% in the year to the second quarter, down from 5.4% in the same quarter of 2004, but still above the 20-year average of 3.5%.



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Output, demand and jobs

Sep 1st 2005
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2005	2006	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 1.9	Q1	+ 2.8	+ 2.3	+ 3.1	+ 1.2	Q1	+ 1.6	Q2	5.0	Jul	5.7
Austria	+ 2.0	Q1	+ 0.8	+ 1.9	+ 2.0	+ 5.8	Jun	+ 3.8	May	5.1	Jul	4.9
Belgium	+ 1.4	Q2	+ 1.2	+ 1.2	+ 1.9	– 1.4	Jun	+ 5.9	Jun	13.4	Jul†	12.8
Britain	+ 1.7	Q2	+ 1.5	+ 2.1	+ 2.1	– 1.9	Jun	+ 1.8	Jul	4.7	Jun††	4.8
Canada	+ 2.7	Q2	+ 3.2	+ 2.7	+ 3.0	+ 1.8	May	+ 5.6	May	6.8	Jul	7.1
Denmark	+ 0.8	Q1	+ 0.6	+ 2.0	+ 2.2	+ 1.5	Jun	+ 6.1	Jul	5.8	Jun	6.5
France	+ 1.2	Q2	+ 0.4	+ 1.5	+ 1.9	– 0.4	Jun	+ 0.8	Jun	9.9	Jul	10.0
Germany	+ 0.6	Q2	nil	+ 1.1	+ 1.3	+ 2.8	Jun	– 3.0	Jul	11.6	Aug§	10.6
Italy	+ 0.1	Q2	+ 2.8	– 0.1	+ 1.2	– 3.0	Jun	– 0.3	May	7.8	Mar	8.2
Japan	+ 1.4	Q2	+ 1.1	+ 1.7	+ 1.7	– 2.2	Jul	+ 3.6	Jun	4.4	Jul	4.9
Netherlands	+ 1.3	Q2	+ 4.9	+ 0.4	+ 1.5	– 0.1	Jun	– 2.3	May	6.7	Jul**	6.5
Spain	+ 3.4	Q2	+ 3.6	+ 3.1	+ 2.8	– 0.2	Jun	+ 1.4	Jun	9.8	Jun	11.1
Sweden	+ 2.2	Q2	+ 2.4	+ 1.9	+ 2.6	+ 2.6	Jun	+ 8.6	Jul	6.9	Jul†	5.6
Switzerland	+ 0.8	Q1	+ 0.2	+ 0.8	+ 1.5	– 0.3	Q1	+ 3.2	Jun	3.5	Jul†	3.6
United States	+ 3.6	Q2	+ 3.3	+ 3.6	+ 3.3	+ 3.0	Jul	+ 7.6	Jun	5.0	Jul	5.5
Euro area	+ 1.1	Q2	+ 1.2	+ 1.3	+ 1.7	+ 0.3	Jun	+ 0.9	Jun	8.7	Jun	8.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 2.0	Q1	+ 0.5	na	na	+ 0.7	Jul	+ 5.8	Jun	7.3	Jul†	7.8
Greece	+ 3.5	Q2	na	na	na	– 2.3	Jun	+ 5.3	May	9.9	Mar	10.8
Iceland	+ 2.9	Q1	na	na	na	na		na		2.1	Jun†	3.1
Ireland	+ 2.4	Q1	+ 1.0	na	na	+ 0.4	Jun	+ 3.4	Jun	4.3	Jul	4.4
Luxembourg	+ 3.1	Q1	na	na	na	+11.2	May	– 1.8	Jun	4.4	Jul	4.0
New Zealand	+ 1.9	Q1	+ 1.5	na	na	+ 3.5	Q4	+ 5.9	Q2	3.7	Q2	4.0
Norway	– 0.8	Q1	+ 2.2	na	na	– 2.7	Jun	+ 3.7	Jun	4.7	Jun‡	4.5
Portugal	+ 0.1	Q1	+ 0.8	na	na	+ 1.2	Jun	– 1.9	Jul	7.2	Q2†	6.3

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ††Apr-Jun; claimant count rate 2.8% in Jul.
§EU harmonised rate 9.0% in Jul. **May-Jul. ‡Apr-Jun.

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Prices and wages

Sep 1st 2005
From The Economist print edition

% change on year ago

	Consumer prices latest		Consumer prices year ago	The Economist poll consumer prices forecast 2005	The Economist poll consumer prices forecast 2006	Producer prices latest		Producer prices year ago	Wages/earnings latest		Wages/earnings year ago
Australia	+ 2.5	Q2	+ 2.5	+ 2.7	+ 2.6	+ 6.9	Q2	+ 2.8	+ 5.8	Q2	+ 3.0
Austria	+ 2.2	Jul	+ 2.2	+ 2.1	+ 1.7	+ 1.1	Jul	+ 6.0	+ 2.3	Jul	+ 2.0
Belgium	+ 3.1	Aug	+ 2.3	+ 2.3	+ 1.8	+ 1.8	Jul	+ 5.5	+ 2.6	Apr	+ 2.3
Britain	+ 2.3	Jul*	+ 1.4	+ 1.9	+ 1.9	+ 3.0	Jul	+ 2.6	+ 4.2	Jun†	+ 4.2
Canada	+ 2.0	Jul	+ 2.3	+ 2.1	+ 2.2	– 0.3	Jul	+ 5.5	+ 1.1	May	+ 3.9
Denmark	+ 2.0	Jul	+ 1.3	+ 1.5	+ 1.7	+ 4.7	Jul	+ 2.7	+ 3.1	Q1	+ 3.3
France	+ 1.7	Jul	+ 2.3	+ 1.8	+ 1.5	+ 2.9	Jun	+ 2.2	+ 2.9	Q2	+ 2.8
Germany	+ 1.9	Aug	+ 2.0	+ 1.6	+ 1.3	+ 2.5	Jul	+ 3.9	+ 0.9	Jun	+ 1.4
Italy	+ 2.0	Aug	+ 2.3	+ 2.1	+ 1.9	+ 3.6	Jul	+ 3.3	+ 3.0	Jun	+ 3.3
Japan	– 0.3	Jul	– 0.1	– 0.1	+ 0.3	+ 1.5	Jul	+ 1.7	– 0.1	Jun	+ 1.8
Netherlands	+ 1.6	Jul	+ 1.1	+ 1.4	na	+ 5.6	Jul	+ 5.2	+ 0.8	Jul	+ 1.0
Spain	+ 3.3	Jul	+ 3.4	+ 3.1	+ 2.8	+ 4.6	Jul	+ 4.1	+ 2.5	Q1	+ 3.2
Sweden	+ 0.3	Jul	+ 0.7	+ 0.5	+ 1.3	+ 3.7	Jul	+ 1.9	+ 1.1	May	+ 3.1
Switzerland	+ 1.0	Aug	+ 1.0	+ 1.1	+ 1.1	+ 1.1	Jul	+ 1.3	+ 0.9	2004	+ 1.4
United States	+ 3.2	Jul	+ 3.0	+ 2.9	+ 2.6	+ 4.6	Jul	+ 4.0	+ 2.7	Jul	+ 2.0
Euro area	+ 2.1	Aug	+ 2.3	+ 2.0	+ 1.6	+ 4.0	Jun	+ 2.4	+ 3.1	Q1	+ 3.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.0	Jul	+ 0.3	na	na	+ 4.0	Jul	+ 1.5	+ 4.0	Q2	+ 3.8
Greece	+ 3.9	Jul	+ 2.9	na	na	+ 5.1	Jul	+ 4.7	na		na
Iceland	+ 3.7	Aug	+ 3.7	na	na	+ 4.3	Aug	+ 5.7	+ 6.6	Jul	+ 5.1
Ireland	+ 2.4	Jul	+ 2.7	na	na	+ 0.2	Jul	– 0.7	+ 6.4	Q1	+ 3.9
Luxembourg	+ 2.6	Jul	+ 2.4	na	na	+ 5.4	Jun	+ 9.2	+ 0.4	May	+ 2.4
New Zealand	+ 2.8	Q2	+ 2.4	na	na	+ 4.7	Q2	+ 1.5	+ 2.6	Q2	+ 2.3
Norway	+ 1.4	Jul	+ 1.5	na	na	+19.3	Jul	+13.9	+ 3.8	Q2	+ 4.1
Portugal	+ 2.2	Jul	+ 2.8	na	na	+ 4.0	Jul	+ 4.2	– 0.2	Jun	– 0.1

*RPI inflation rate 2.9% in Jul. †Apr-Jun.

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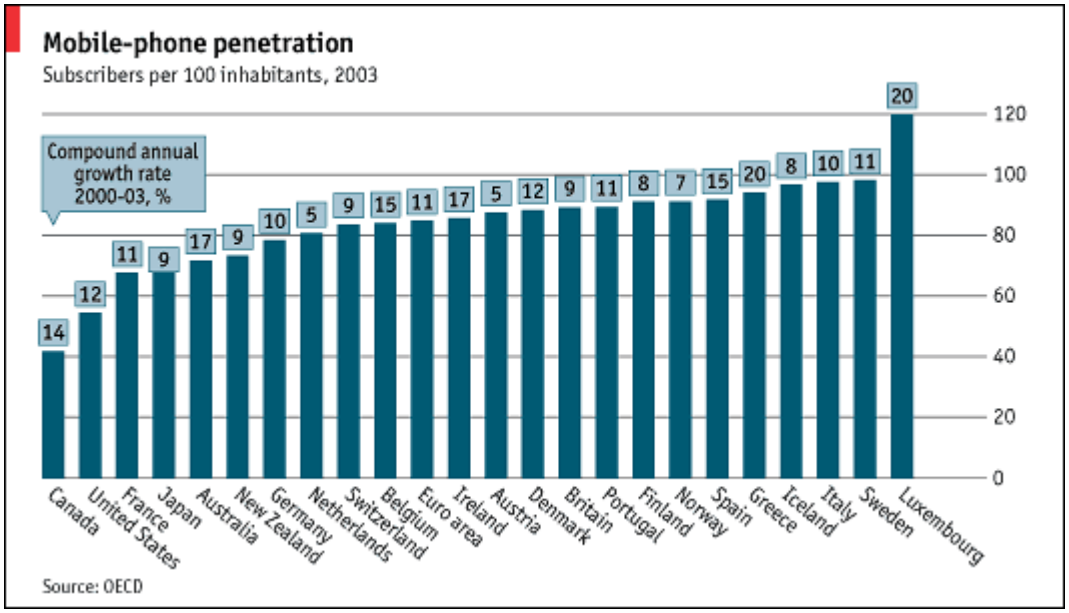
Mobile-phone penetration

Sep 1st 2005
From The Economist print edition



There is almost one mobile phone for every person in much of the developed world, according to new figures from the OECD. In Luxembourg, phones outnumber people, since many people who live in neighbouring countries have a second handset for use within its borders. Despite their enthusiasm for PCs and broadband links, Canada and the United States have been slower to adopt mobile phones than other rich countries.

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Money and interest rates

Sep 1st 2005
From The Economist print edition

	Money supply* % change on year ago			Interest rates % a year (Aug 31st 2005)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 6.5	+ 8.8	Jul	5.62	5.43	4.99	5.06	5.50	6.02
Britain	+ 4.9	+11.3	Jul	4.53	4.91	4.10	4.15	4.92	5.18
Canada	+ 6.5	+10.2	Jul	2.76	2.20	2.98	3.77	4.61	5.11
Denmark	+22.0	+15.7	Jul	2.20	2.15	2.19	3.04	4.12	4.89
Japan	+ 4.4	+ 1.7	Jul	0.02	0.03	0.13	1.35	1.56	1.46
Sweden	+ 3.6	+ 8.1	Jul	1.49	2.00	2.08	2.97	4.33	2.79
Switzerland	+ 0.5	+ 7.3	Jul	0.76	0.65	0.90	1.87	2.61	1.87
United States	+ 1.1	+ 5.0	Jul	3.67	1.65	3.83	4.04	4.12	5.04
Euro area†	+11.1	+ 7.9	Jul	2.13	2.12	2.21	3.08	3.99	3.35

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.25%, Japan No. 270 1.42%. Central bank rates: US fed funds 3.50%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.5%. Sources: Bank of Canada, Commerzbank, Danske Bank, J.P. Morgan Chase, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Sep 1st 2005
From The Economist print edition

2000=100

	Aug 23rd	Aug 30th*	% change on one month	% change on one year
Dollar index				
All items	132.6	131.7	– 3.8	+ 5.6
Food	123.2	121.5	– 6.7	+ 0.9
Industrials				
All	144.8	144.9	– 0.4	+11.2
Nfa†	127.7	128.5	– 4.8	– 4.3
Metals	154.1	153.8	+ 1.8	+20.0
Sterling index				
All items	111.8	111.9	– 4.5	+ 6.4
Euro index				
All items	100.5	99.9	– 3.6	+ 5.3
Yen index				
All items	135.0	136.3	– 3.6	+ 7.3
Gold				
$ per oz	439.15	430.55	– 0.5	+ 5.0
West Texas Intermediate				
$ per barrel	65.38	69.87	+12.9	+65.8

* Provisional. † Non-food agriculturals.

Our commodity-price index was rebased in February 2005.

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Stockmarkets

Sep 1st 2005
From The Economist print edition

Market indices

	Aug 31st	2005 high	2005 low	% change on one week	% change on record high	% change on Dec 31st 2004 in local currency	% change on Dec 31st 2004 in $ terms
Australia (All Ordinaries)	4,413.5	4,462.7	3,905.5	– 0.1	– 1.1	+ 8.9	+ 4.3
Austria (ATX)	3,285.2	3,285.2	2,415.0	+ 2.8	nil	+35.1	+22.3
Belgium (Bel 20)	3,224.0	3,314.8	2,958.8	– 0.3	–12.4	+ 9.9	– 0.5
Britain (FTSE 100)	5,296.9	5,377.5	4,783.6	+ 0.4	–23.6	+10.0	+ 3.1
Canada (Toronto Composite)	10,668.9	10,699.9	9,006.2	+ 1.5	– 6.3	+15.4	+16.4
Denmark (KBX)	330.8	337.5	257.8	nil	– 2.0	+28.3	+15.8
France (SBF 250)	3,068.5	3,146.1	2,633.6	– 0.3	–30.1	+16.5	+ 5.4
(CAC 40)	4,399.4	4,527.1	3,816.1	– 0.6	–36.4	+15.1	+ 4.2
Germany (DAX)*	4,829.7	4,990.6	4,178.1	– 1.8	–40.1	+13.5	+ 2.7
Italy (S&P/MIB)	33,520.0	34,027.0	30,645.0	– 0.4	–33.1	+ 8.5	– 1.9
Japan (Nikkei 225)	12,413.6	12,502.3	10,825.4	– 0.7	–68.1	+ 8.0	– 0.3
(Topix)	1,271.3	1,275.6	1,109.2	– 0.3	–55.9	+10.6	+ 2.0
Netherlands (AEX)	389.6	401.6	347.0	– 0.1	–44.5	+11.9	+ 1.3
Spain (Madrid SE)	1,080.5	1,103.7	950.9	– 0.6	– 5.7	+12.7	+ 1.9
Sweden (Affarsvarlden Gen)	256.8	263.6	218.9	– 0.2	–35.9	+16.1	+ 1.6
Switzerland (Swiss Market)	6,517.2	6,689.2	5,669.6	– 0.3	–22.5	+14.5	+ 3.4
United States (DJIA)	10,481.6	10,940.6	10,012.4	+ 0.4	–10.6	– 2.8	– 2.8
(S&P 500)	1,220.3	1,245.0	1,137.5	+ 0.9	–20.1	+ 0.7	+ 0.7
(NASDAQ Comp)	2,152.1	2,218.2	1,904.2	+ 1.1	–57.4	– 1.1	– 1.1
Europe (FTSEurofirst 300)†	1,177.2	1,199.9	1,038.6	– 0.3	–31.0	+13.0	+ 2.2
Euro area (FTSE Euro 100)†	997.9	1,026.7	894.4	– 0.8	–35.6	+10.8	+ 0.2
World (MSCI)‡	1,194.8	1,212.0	1,115.0	+ 0.5	–17.5	+ 2.2	+ 2.2
World bond market (Citigroup)††	644.8	662.3	626.9	+ 0.5	– 2.6	– 3.2	– 3.2

*Total return index. †In euro terms. ‡Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms. ††Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Sep 1st 2005
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current-account balance $bn latest 12 mths		The Economist poll % of GDP, forecast 2005	2006	Exchange rate trade-weighted† 2000=100 Aug 31st	year ago	Currency units per $ Aug 31st	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2005‡
Australia	− 16.5	Jul	− 43.1	Q2	− 5.9	− 5.6	115.8	109.0	1.33	1.42	2.39	1.64	1.20	+ 0.9
Austria	− 1.5	Jun	nil	Jun	− 0.3	− 0.3	103.7§	103.8	0.81	0.82	1.46	–	0.73	− 2.0
Belgium	+ 15.1	Jun	+ 12.2	Mar	+ 2.9	+ 2.8	104.1§	104.2	0.81	0.82	1.46	–	0.73	− 0.5
Britain	−111.2	Jun	− 44.0	Q1	− 2.5	− 2.6	99.2	100.2	0.56	0.56	–	0.68	0.50	− 2.9
Canada	+ 46.2	Jun	+ 16.3	Q2	+ 1.3	+ 1.2	121.4	110.4	1.19	1.31	2.14	1.46	1.07	+ 1.2
Denmark	+ 9.9	Jun	+ 10.8	Jun	+ 2.0	+ 1.8	105.9	105.9	6.05	6.11	10.9	7.46	5.46	+ 1.8
France	− 26.4	Jun	− 22.6	Jun	− 0.7	− 0.5	106.6§	106.8	0.81	0.82	1.46	–	0.73	− 3.0
Germany	+198.5	Jun	+108.5	Jun	+ 3.7	+ 3.5	104.3§	104.5	0.81	0.82	1.46	–	0.73	− 3.5
Italy	− 6.8	May	− 23.7	Jun	− 1.4	− 1.5	76.4§	76.5	0.81	0.82	1.46	–	0.73	− 4.4
Japan	+113.2	Jun	+166.0	Jun	+ 3.5	+ 3.4	85.7	87.7	111	109	200	137	–	− 6.1
Netherlands	+ 40.9	Jun	+ 28.3	Q2	+ 3.7	+ 3.6	103.5§	103.6	0.81	0.82	1.46	–	0.73	− 2.2
Spain	− 89.4	Jun	− 72.6	May	− 5.4	− 5.5	77.0§	77.1	0.81	0.82	1.46	–	0.73	+ 0.5
Sweden	+ 22.2	Jul	+ 27.9	Q2	+ 5.7	+ 5.2	96.2	98.5	7.59	7.50	13.7	9.34	6.84	+ 0.8
Switzerland	+ 7.1	Jul	+ 40.2	Q1	+11.2	+10.8	106.9	107.3	1.25	1.26	2.26	1.55	1.13	− 1.0
United States	−723.4	Jun	−717.0	Q1	− 6.3	− 6.2	84.9	87.0	–	–	1.80	1.23	0.90	− 4.1
Euro area	+ 61.5	Jun	+ 16.1	Jun	+ 0.4	+ 0.4	116.3	115.3	0.81	0.82	1.46	–	0.73	− 2.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 12.1	Jun	+ 6.0	Jun	na	na	81.2§	81.4	0.81	0.82	1.46	–	0.73	+ 1.3
Greece	− 33.7	May	− 15.5	Jun	na	na	59.7§	59.8	0.81	0.82	1.46	–	0.73	− 3.8
Iceland	− 0.9	Jun	− 1.4	Q1	na	na	105.7**	95.1	62.7	72.3	113	77.1	56.4	+ 1.1
Ireland	+ 40.2	Jun	− 3.1	Q1	na	na	93.6§	93.7	0.81	0.82	1.46	–	0.73	− 0.7
Luxembourg	− 4.4	May	+ 3.0	Q1	na	na	104.1§	104.2	0.81	0.82	1.46	–	0.73	− 0.8
New Zealand	− 3.7	Jul	− 7.0	Q1	na	na	135.7	130.2	1.43	1.52	2.57	1.76	1.29	+ 3.2
Norway	+ 41.2	Jul	+ 37.9	Q1	na	na	111.3	104.0	6.39	6.86	11.5	7.86	5.75	+ 14.4
Portugal	− 20.6	May	− 15.7	Jun	na	na	94.3**	93.3	0.81	0.82	1.46	–	0.73	− 5.3

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, June average. ‡OECD forecast. **IMF, April average.

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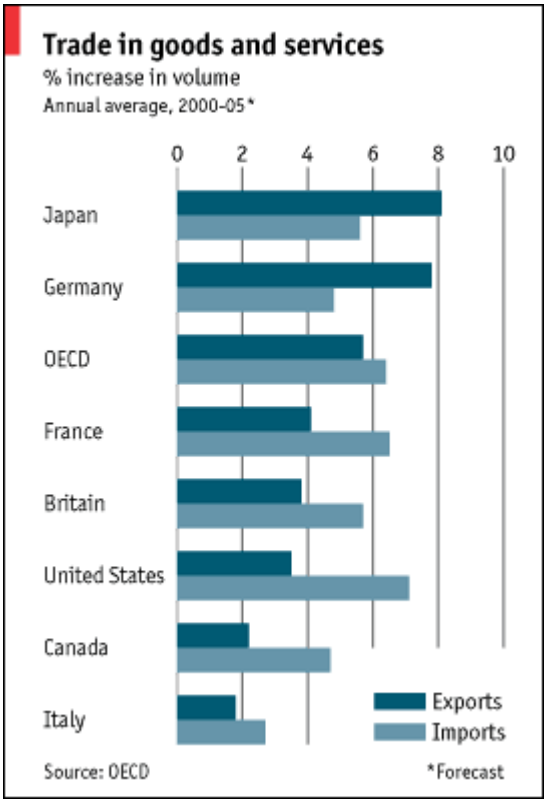
Trade in goods and services

Sep 1st 2005
From The Economist print edition



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Overview

Sep 1st 2005
From The Economist print edition

Indonesia's rupiah tumbled as investors took fright at the impact of higher world oil prices on a national economy burdened by big fuel subsidies. The central bank sought to calm nerves by sharply raising interest rates.

In **Brazil**, GDP grew by 3.9% in the year to the second quarter. Over the same period, it increased by 6.8% in **Hong Kong**, 4.8% in the **Philippines** and 4.1% in **Hungary**.

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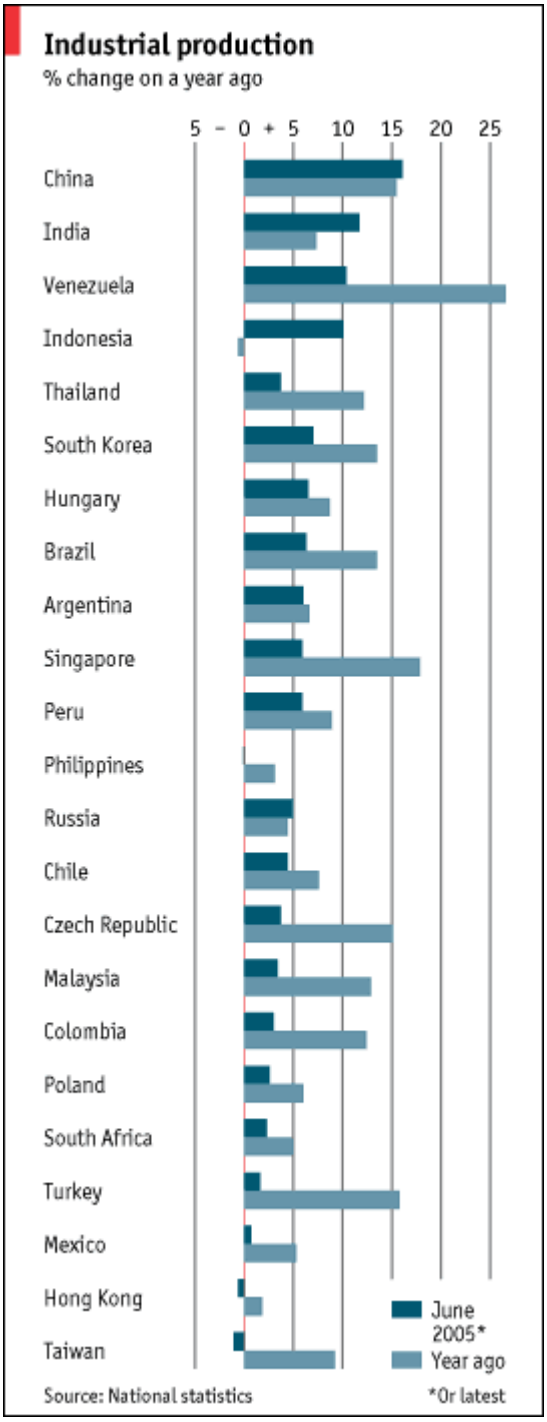
Industrial production

Sep 1st 2005
From The Economist print edition

In only four of the 23 countries in our chart has industrial output risen faster in the past 12 months than in the previous year. China's factories remain the busiest: industrial production has increased by an annual rate of around 16% for two years in a row. Production in India has also accelerated, rising by 11.7% in the past 12 months, up from 7.3% growth the year before.



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Economy

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	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.5	Q2	+16.1	Jul	+ 1.8	Jul	+87.6	Jul	+68.7	2004	711.0	Jun
Hong Kong	+ 6.8	Q2	– 0.6	Q1	+ 1.3	Jul	– 9.6	Jul	+18.5	Q1	121.9	Jul
India	+ 7.0	Q1	+11.7	Jun	+ 4.1	Jul	–33.0	Jul	– 6.4	Q1	130.1	Jul
Indonesia	+ 5.5	Q2	+10.1	Mar	+ 8.3	Aug	+27.4	Jun	+ 7.8	Q1	32.6	Jun
Malaysia	+ 4.1	Q2	+ 3.4	Jun	+ 3.0	Jul	+24.0	Jun	+16.7	Q1	78.0	Jul
Philippines	+ 4.8	Q2	– 0.1	Jun	+ 7.1	Jul	– 0.8	Jun	+ 2.9	Mar	15.1	Jul
Singapore	+ 5.2	Q2	+ 5.9	Jul	+ 0.1	Jul	+16.9	Jul	+32.5	Q2	116.3	Jul
South Korea	+ 3.3	Q2	+ 7.0	Jul	+ 2.0	Aug	+26.0	Aug	+21.3	Jul	205.6	Jul
Taiwan	+ 3.0	Q2	– 1.1	Jul	+ 2.4	Jul	+ 2.1	Jul	+13.3	Q2	253.6	Jul
Thailand	+ 3.3	Q1	+ 4.7	Jul	+ 5.3	Jul	– 7.3	Jul	– 2.2	Jul	47.3	Jul
Argentina	+ 8.0	Q1	+ 6.0	Jul	+ 9.6	Jul	+11.2	Jul	+ 2.8	Q1	22.3	Jun
Brazil	+ 3.9	Q2	+ 6.3	Jun	+ 6.6	Jul	+39.9	Jul	+13.4	Jul	59.4	Jun
Chile	+ 6.5	Q2	+ 4.4	Jul	+ 3.1	Jul	+ 8.7	Jul	+ 0.6	Q2	16.2	Jul
Colombia	+ 3.6	Q1	+ 3.0	Jun	+ 4.9	Jul	+ 1.6	May	– 0.8	Q1	13.7	Jul
Mexico	+ 3.1	Q2	+ 0.7	Jun	+ 4.5	Jul	– 9.6	Jul	– 8.4	Q2	65.6	Jun
Peru	+ 4.6	Jun	+ 5.9	Jun	+ 1.4	Jul	+ 3.8	Jun	+ 0.4	Q2	14.5	Jul
Venezuela	+11.1	Q2	+10.4	May	+15.3	Jul	+24.7	Q2	+17.7	Q2	22.3	May
Egypt	+ 4.7	Q4	+ 3.3	2004†	+ 4.7	Jun	– 9.5	Q1	+ 4.4	Q1	17.6	Jun
Israel	+ 4.8	Q2	+ 0.5	Jun	+ 1.6	Jul	– 8.0	Jul	+ 1.9	Q1	24.5	Jul
South Africa	+ 4.5	Q2	+ 2.3	Jun	+ 3.4	Jul	– 2.3	Jul	– 8.5	Q1	17.2	Jul
Czech Republic	+ 4.4	Q1	+ 3.7	Jun	+ 1.7	Jul	+ 1.0	Jun	– 4.4	Q1	29.8	Jul
Hungary	+ 4.1	Q2	+ 6.5	Jun	+ 3.7	Jul	– 2.7	Q1	– 9.2	Q1	17.7	Jul
Poland	+ 2.8	Q2	+ 2.6	Jul	+ 1.3	Jul	– 3.4	Jun	– 0.2	Jun	39.8	Jun
Russia	+ 5.2	Q1	+ 4.9	Jul	+12.5	Jul	+106.9	Jun	+69.2	Q1	140.9	Jul
Turkey	+ 4.8	Q1	+ 1.6	Jun	+ 7.8	Jul	–38.9	Jul	–19.3	Jun	40.0	Jun
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 7.2	Q1	+11.1	Jul	+ 3.8	Jul	– 2.3	Jun	– 1.3	Jun	1.7	Jun
Latvia	+ 7.4	Q1	+ 9.0	Jun	+ 6.1	Jul	– 2.7	Jun	– 1.5	Jun	2.1	Jun
Lithuania	+ 8.2	Q2	na		+ 1.8	Jul	– 3.2	Jun	– 1.5	Q1	3.4	Jun
Slovakia	+ 5.1	Q2	+ 1.6	Jun	+ 2.0	Jul	– 2.0	Jun	– 2.3	May	15.1	Jun
Slovenia	+ 2.6	Q1	+ 1.0	Jun	+ 2.3	Jul	– 1.3	Jun	nil	Jun	7.7	May
Pakistan	+ 8.4	2005†	+13.6	Apr	+ 9.0	Jul	– 6.7	Jul	– 1.5	Q2	10.4	May
Saudi Arabia	+ 5.2	2004	na		+ 0.6	Jun	+84.9	2004	+51.5	2004	26.7	May

*Excluding gold, except Singapore; IMF definition. †Year ending June.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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Financial markets

Sep 1st 2005
From The Economist print edition

	Currency units per $ Aug 31st	Currency units per $ year ago	Currency units per £ Aug 31st	Interest rates short-term % a year	Stockmarkets Aug 31st	% change on one week	% change on Dec 31st 2004 in local currency	% change on Dec 31st 2004 in $ terms
China	8.10	8.28	14.6	2.50	1,222.2	−0.4	− 8.1	− 6.1
Hong Kong	7.77	7.80	14.0	3.80	14,903.6	+0.2	+ 4.7	+ 4.7
India	44.1	46.3	79.3	5.15	7,805.4	+2.5	+ 18.2	+ 16.6
Indonesia	10,300	9,324	18,526	10.78	1,050.1	+1.4	+ 5.0	− 5.4
Malaysia	3.77	3.80	6.78	2.89	913.6	−1.4	+ 0.7	+ 1.4
Philippines	56.3	56.2	101.3	7.31	1,936.9	+0.7	+ 6.3	+ 5.9
Singapore	1.68	1.71	3.03	2.00	2,275.4	−0.1	+ 10.1	+ 6.7
South Korea	1,041	1,150	1,871	3.51	1,083.3	−1.0	+ 20.9	+ 20.3
Taiwan	32.8	33.9	58.9	1.45	6,033.5	−1.5	− 1.7	− 4.9
Thailand	41.3	41.6	74.3	3.50	697.9	+0.3	+ 4.5	− 1.8
Argentina	2.91	3.00	5.24	4.93	1,581.7	+3.0	+ 15.0	+ 17.4
Brazil	2.37	2.93	4.25	19.73	28,044.8	+5.0	+ 7.1	+ 20.2
Chile	541	627	973	3.72	9,757.5	−1.3	+ 8.9	+ 11.8
Colombia	2,304	2,533	4,143	6.94	6,708.0	−3.3	+ 54.4	+ 57.6
Mexico	10.8	11.4	19.4	9.42	14,243.2	−2.5	+ 10.3	+ 13.7
Peru	3.28	3.37	5.90	2.99	4,611.8	+1.1	+ 24.3	+ 24.2
Venezuela	2,502§	2,684§	4,501	11.23	19,702.2	+4.6	− 34.2	− 32.2
Egypt	5.77	6.23	10.38	9.32	42,388.1	+2.3	+ 72.4	+ 81.3
Israel	4.53	4.51	8.16	3.91	715.1	+0.6	+ 11.1	+ 5.8
South Africa	6.45	6.63	11.6	7.10	15,414.0	−0.1	+ 21.8	+ 6.4
Czech Republic	24.0	26.1	43.1	1.79	1,350.9	+3.1	+ 30.9	+ 22.0
Hungary	199	204	357	6.09	21,572.9	+2.6	+ 46.3	+ 33.1
Poland	3.28	3.65	5.89	4.61	31,364.3	+2.2	+ 17.8	+ 7.7
Russia	28.5	29.2	51.2	13.00	882.0‡	+2.1	+ 47.6	+ 43.6
Turkey	1.34	1.51	2.41	16.17	30,908.0	+5.2	+ 23.8	+ 24.3
EM (MSCI)*	1.00	1.00	1.80	na	606.2	+0.3	+ 11.8	+ 11.8
EMBI+†	1.00	1.00	1.80	na	354.0	+1.4	+ 7.4	+ 7.4

*Emerging Mkts. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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